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No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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December 10, 1987

QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission (FERC) has erroneously interpreted its statutory responsibility by creating presumptions favoring applicants and switching burdens of proof to non-applicants for proceedings to construct new facilities and provide new service.

2. Whether the FERC's adoption of the Optional Expedited Certificate Procedure (OECP) with its presumptions favoring applicants who wish to bypass existing utility service is supported by substantial evidence and reflects reasoned decision-making.

3. Whether the FERC has unlawfully abandoned its statutory responsibility by limiting its analysis of applications filed under the OECP.

4. Whether the OECP is ripe for review.

5. Whether the action of the FERC has interfered with the lawful exercise of state authority.

6. Whether state authority over transportation of gas to end users within a state must be clarified.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii
PARTIES TO THE PROCEEDING BELOW	vi
LIST OF SUBSIDIARIES AND AFFILIATES PURSUANT TO RULE 28.1	x
OPINIONS BELOW	1
JURISDICTION	2
STATUTES INVOLVED	2
REASONS FOR GRANTING THE WRIT	4
I. This Court Should Review to Correct the FERC's Erroneous and Unsupported Interpretation of its Statutory Responsibility	5
II. The Procedure Established for Optional Expedited Certificates is Ripe for Review	9
III. This Court Should Review to Clarify the Scope of State Jurisdiction over Transportation Within its Boundaries	11
IV. This Court Should Review to Prevent the FERC from Interfering with the Lawful Exercise of State Authority	14
CONCLUSION	16

TABLE OF AUTHORITIES

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Page(s)

Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987) 1, 6, 9, 11, 14

Atlantic Refining Company v. Public Service Commission (CATCO), 360 U.S. 378, 391 (1959) 6, 15

City of Pittsburgh v. FPC, 237 F.2d 741, 752 (D.C. Cir. 1956) 6

Consumer Federation of America v. FPC, 515 F.2d 347, 356 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 906 (1975) 6

Farmers Union Central Exchange, Inc. v. FERC, 734 F.2d 1486, 1510 (D.C. Cir.), *cert. denied*, 469 U.S. 1034 15

FPC v. East Ohio Gas Co., 338 U.S. 464 (1950) 11, 13

FPC v. Texaco, Inc., 417 U.S. 380, 400 (1974) 19

FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 8 (1961) 6, 12

FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 at 28 13

Interstate Natural Gas Co. v. FPC, 331 U.S. 682, 690 (1947) 11

Maryland v. Louisiana, 451 U.S. 725 (1981) 14

Maryland's People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) (MPC I) 6, 15

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Missouri Edison Co. v. FPC, 479 F.2d 1185 (D.C. Cir. 1973) 7

Panhandle Eastern Pipeline Co. v. FPC, 232 F.2d 467, 472 (3d Cir. 1956), *cert. denied*, 352 U.S. 891 (1956) 8

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ANR Pipeline Company, 34 FERC ¶61,238, 61,412 (Feb. 28, 1986) 13

Iroquois Gas Transmission System, 51 FR 23267 (June 20, 1987) 10

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Legislative History

Page(s)

H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937) 11

Statutes

Section 1(b), Natural Gas Act, 15 U.S.C. §717(b) (1938) 2, 7, 13, 14
Section 7(a), Natural Gas Act, 15 U.S.C. §717f(a) (1938) 2, 3
Section 7(c), Natural Gas Act, 15 U.S.C. §717f(c) (1938) 2, 3, 5, 7, 10
Section 7(e), Natural Gas Act, 15 U.S.C. §717f(e) (1938) 2, 3, 5
Section 19(b), Natural Gas Act, 15 U.S.C. §717(r) (1938) 2
Section 4, Administrative Procedure Act, 5 U.S.C. §553 (1966) 2, 3, 8
Section 311, Natural Gas Policy Act, 15 U.S.C. Section 3371 3

PARTIES TO THE PROCEEDING

Air Products & Chemicals, Inc.
Alabama—Tennessee Natural Gas Company
American Bakers Association
American Gas Association
American Iron & Steel Institute
American Paper Institute
American Public Gas Association
AMOCO Gas Company
ANA Pipeline Company
Arco Oil & Gas Company
Arizona Electric Power Cooperative, Inc.
Arizona Public Service Company
Arkla, Inc.
Ashland Corporation
Ashland Exploration, Inc.
Association for Texas Intrastate Natural
Atlanta Gas Light Company
Baltimore Gas and Electric Company
Bethlehem Steel Corp.
Brooklyn Union Gas Co.
Brooklyn Union Gas Company
Cabot Corporation
Carolina Utility Customers Association
Cascade Natural Gas Corp.
Cenoco, Inc.
Central Illinois Light Co., et al.
Champlin Petroleum Company
Chemical Manufacturers Association
Chevron U.S.A., Inc.
Cities Service Oil & Gas Corporation
Citizen Energy Corp.
Citizens Energy Corp.
City of Willcox, Arizona
Coke Company
Columbia Gas Transmission Co.

Columbia Gas Transmission Corp.
Columbia Nitrogen Corp.
Consolidated Edison of New York, Inc.
Consolidated Gas Transmission Corporation
Consumer Power Company
CP National Corp.
Delhi Gas Pipeline Corp.
El Paso Natural Gas Company
Elizabethtown Gas Company
Extex, Inc.
Exxon Corporation
Fertilizer Institute
Florida Transmission Company
Foothills Pipelines
Gas Pipelines
Interstate Natural Gas Association of America
K. N. Energy, Inc.
Kerr-McGee Corporation
Laclede Gas Company
Louisiana Intrastate Gas Corp.
Marathon Oil Company
Maryland Industrial Group
Maryland People's Counsel
Memphis Light, Gas and Water Division
Mesa Operating Limited Partnership
Michigan Consolidated Gas Co.
Michigan Public Service Commission
Minnesota Public Utilities Commission
Mobil Oil Corporation
Monterey Pipeline Company
National Association of Regulatory Utility Commissioners
National Gas Pipeline Company of America
North Shore Gas Company
Northern Illinois Gas Co.
Northern Natural Gas Company
Northern Valley Environmental Council
Northwest Central Pipeline Corporation

Northwest Gas Company
Ohio Oil and Gas Association
Oklahoma National Gas Company
Pacific Gas and Electric Company
Pacific Gas Transmission Co.
Pan-Alberta Gas, Ltd.
Panhandle Eastern Pipeline Corporation
Panhandle Producers and Royalty Owners Association
Pennsylvania Public Utility Commission
Pennzoil Company, et al.
Phelp Dodge Corporation
Philadelphia Electric Co.
Phillips Petroleum Co., et al.
Piedmont Natural Gas Co.
Placid Oil Company
Power District and Gas Distributors Information Service
Process Gas Consumers Group
Producer's Gas Company
Public Service Electric and Gas Co.
Public Utilities Commission of the State of California
Salt River Project Agricultural Improvement
Shell Offshore, Inc.
Shell Western Electric and Paun, Inc.
Sohio Petroleum Company
South Jersey Co.
Southern California Gas Company
Southern Carolina Pipeline Corp.
Southern Indiana Gas and Electric Company
Southern Natural Gas Co.
Southern Natural Gas Company
State Corporation Commission, State of Kansas
State of Connecticut
State of Louisiana
State of Michigan
State of New York
Tenneco Oil Company
Tennessee Gas Pipeline Company

Tenngasco Corp.
Texas Exploration Corporation
Texas Gas Transmission Corporation
The Peoples Gas Light
Transok Inc.
Transwestern Pipeline Co.
Trunkline Gas Company
UGI Corp.
Union Oil Co., of California
Union Oil Company
United Distribution Companies
United Gas Pipeline Company
Valero Transmission Co.
Washington Gas Light Co.
Washington National Gas Company
Weirton Steel Corp.
West Coast Transmission Company Limited
West Virginia Consumer Advocate
Wisconsin Power & Light Co.

LIST OF SUBSIDIARIES AND AFFILIATES PURSUANT TO RULE 28.1

Pacific Lighting Corporation

Dual Fuel Systems, Inc. (California)—Dissolution Pending
8309 Tujunga Avenue Corp. (California)
Pacific Center Downtown, Inc. (California)
Pacific Enterprises (California)
Pacific Library Tower (California)
Pacific Lighting Land Company (California)
Sabagli N.V. (Netherlands Antilles)
Southern California Tower (California)
Pacific Indonesia LNG Company (50%) (California)
Pacific Lighting Capital Company (Netherlands Antilles)
Pacific Lighting Gas Development Company (California)
Pacific Lighting Overseas Finance N.V. (Netherlands Antilles)
Pacific Synthetic Fuel Company (California)
Pacific Western Resources Company (California)
Southern California Conservation Financing Company (California)

Pacific Lighting Energy Systems (California)

Central Plants, Inc. (California)
Modular Products, Inc. (California)—Dissolution Pending
Pacific Energy Resources Incorporated (California)
Pacific Geothermal Company (California)
Pacific Hydropower Company (California)
Western Power, Inc. (Washington)
Pacific Lighting Bio-Energy Company (California)
Pacific Oroville Power, Inc. (California)
Pacific Penobscot Power Company (Maine)
Pacific Recovery Corporation (California)
Pacific Wood Fuels Company (California)

Pacific Interstate Company (California)

Pacific Gas Gathering Company (California)
Pacific Interstate Mojave Company (California)
Pacific Interstate Offshore Company (California)
Pacific Interstate Transmission Company (California)
Pacific Interstate Transmission Company (Arctic) (California)
Pacific Offshore Pipeline Company (California)

Pacific Lighting Leasing Company (California)

Pacific Lighting Commercial Loans, Inc. (California)

Pacific Lighting Oil and Gas Company (California)

Pacific Lighting Exploration Company (California)
Terra Resources, Inc. (Delaware)

Pacific Lighting Real Estate Group (California)

Presley ASW Finance Co., Inc. (California)
Presley Financial Corporation (California)
Presley-Home Mac Finance Co., Inc. (California)
Presley RAC Finance Co., Inc. (California)

Southern California Gas Company (California)

Pacific Lighting International Finance N.V. (Netherlands Antilles)
Southern California Gas International Finance N.V. (Netherlands Antilles)
Southern California Gas Tower (California)

Thrifty Corporation (California)

FTM Sports Corporation (50%) (California)
American Diversified Sports, Inc. (80%) (Florida)
Gart Bros. Sporting Goods Company (Colorado)
Colorado Wholesale Sporting Goods Co., Inc. (Colorado)
Sports Castle Travels, Inc. (89%) (Colorado)

Michigan Sporting Goods Distributors, Inc. (Michigan)
Rexall Square Drugs, Inc. (California)
The Newman Importing Company, Inc. (California)
Thrifty Jr. Inc. (California)
Thrifty Realty Company (California)
Thrifty Wilshire, Inc. (California)
United Merchandising Corp. (California)

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Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Southern California Gas Company ("SoCalGas") respectfully petitions this Court for review of a decision of the United States Court of Appeals for the District of Columbia Circuit affirming portions of Order No. 436, *et seq.*, ("Order No. 436") of the Federal Energy Regulatory Commission ("FERC" or "Commission").

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 824 F.2d 981 (D.C. Cir. 1987) and is reproduced in the Appendix to this Petition (App. B). The Orders of the FERC are reported as follows:

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol (Order No. 436), 50 Fed. Reg. 42,408 (Oct. 18, 1985), [Reg. Preambles 1982-1985] FERC Stats. & Regs.

¶30,665 (Oct. 9, 1985), *modified,* Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985), [Reg. Preambles 1982-1985] FERC Stats. & Regs. ¶30,675 [Dec. 12, 1985], *modified further,* Order No. 436-B, 51 Fed. Reg. 6398 (Feb. 24, 1986), III FERC Stats. & Regs. ¶30,688 (Feb. 14, 1986), *reh'g denied,* Order No. 436-C, 34 FERC ¶61,404 (Feb. 14, 1986), *reh'g denied,* Order No. 436-D, 34 FERC ¶61,405 (Mar. 28, 1986), *reconsideration denied,* Order No. 436-E, 34 FERC ¶61,403 (Mar. 28, 1986).

JURISDICTION

The order of the Court of Appeals was issued June 23, 1987, and entered following a denial of timely petitions for rehearing and suggestions for rehearing en banc on September 15, 1987. (App. A-1). The jurisdiction of this Court is invoked under 28 U.S.C. §§1254(1), 2101(c), and 2350 (1982).

STATUTES INVOLVED

The principal statutory provisions involved are Sections 1(b), 7(a), 7(c), 7(e), 19(b) of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. §§717(b), 717f(a), 717f(c), 717f(e), 717(r), Section 311, Natural Gas Policy Act, 15 U.S.C. Section 3371, and Section 4 of the Administrative Procedure Act, 5 U.S.C. §553.

STATEMENT OF THE CASE

This case involves orders of the FERC which "envisage a complete restructuring of the natural gas industry." (App. B-17.) Included within the FERC Order is a procedure and

substantive presumption which, unless vacated or revised, will negate a 50-year policy which fairly recognized the statutory division of responsibility concerning the regulation of natural gas between the states and federal agencies, and which arrogates to the FERC a disproportionate and unintended share of this economic power.

On May 30, 1985, the FERC issued a Notice of Proposed Rulemaking ("NOPR") which "proposed significant changes to our regulation of natural gas pipeline companies in light of the many changes in the natural gas industry over the years." The NOPR proposed a package of four interrelated parts. A simplified "blanket" transportation program was proposed to replace existing self-implementing transportation programs under Section 7 of the Natural Gas Act, 15 U.S.C. § 717f, and Section 311 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3371. The FERC also proposed to allow interstate pipelines to obtain expedited certificates enabling them to construct and operate new facilities and offer certain new services. This Optional Expedited Certificate Procedure ("OECP") provided for minimal regulatory review and an automatic presumption that the proposal was in the public interest if the applicant complied with limited conditions concerning the economic risk of the venture. The Commission also initially proposed certain treatment for take-or-pay contract settlements and to segment purchased gas costs into blocks to place downward pressure on gas prices.

The final rule retained the transportation program, eliminated the take-or-pay program, and deferred the block billing proposal. The final rule promulgated the OECP but provided an additional notice requirement in the event the proposal included "bypass" of a local distribution company ("LDC").

The Circuit Court vacated and remanded Order No. 436 for reasons related to provisions of the transportation program and for failure to deal with take-or-pay problem contracts. As to the OECP, the Circuit Court notes the concern of LDCs and

state commissions that the OECP would facilitate pipelines in bypassing LDCs to serve attractive customers.

The Circuit Court finds that the OECP was not ripe for review since no application had raised the problem with the FERC, the Court would be issuing an advisory opinion, and, petitioners had not shown any hardship if the OECP was not adjudicated now.

As to the substance of the proposal, the Circuit Court rejects arguments that failure to consider the waste in duplicative facilities and the adverse impact on customers of bypassed LDCs' invalidates the presumption favoring applicants. Particularly, the Circuit Court justifies the OECP in that the applicant pipeline bears some risk of loss, that construction seems likely only where wasteful investment seems remote, and that state regulatory commissions can keep the impact slight and protect consumers. The Circuit Court noted the possibility of concurrent state regulation over bypass transportation and endorsed the ability of state commissions to protect consumers.

Judge Mikva concurs with the vast majority of the opinion but dissents as to the impact of the OECP on the grounds that it may prevent state commissions from providing "affordable energy for their residents" and the ease it will provide pipelines to bypass LDCs.

SoCalGas, among others, sought rehearing of the Circuit Court opinion limited to its upholding of the OECP. Rehearing, however, was denied.

REASONS FOR GRANTING THE WRIT

In evaluating applications to construct facilities or provide new services, the FERC is obligated to make certain public interest findings, to evaluate all aspects of the application, and to consider the impact of the proposal on the consuming public. In that regard, the FERC and the NGA have required the

applicant to bear the burden of proof and, in cases involving the bypass of an LDC, the FERC and the Courts have established a presumption favoring service to all end users by the existing LDC.

The opinion below upholds the substance of the OECP and finds the procedure not ripe for review. By doing so, the Circuit Court condones the creation of a new presumption favoring an applicant wishing to bypass the LDC and transferring the burden to the opponent of an application.

In reinterpreting its statutory responsibility, the FERC also proposes to restrict its consideration of an application, under the OECP, to limited and direct economic considerations. The FERC relies on state commissions to protect consumers from the impact. State authority to regulate such transactions, however, has never been defined and may not, in fact, exist.

Thus, the FERC is vacating an area it has traditionally regulated, created a possible regulatory gap, abolished an historic preference for LDC service to consumers, and failed to describe or investigate the ability or inability of the states to fill the gap.

Review by this Court is thus warranted.

I

THIS COURT SHOULD REVIEW TO CORRECT THE FERC'S ERRONEOUS AND UNSUPPORTED INTERPRETATION OF ITS STATUTORY RESPONSIBILITY

Under the Natural Gas Act (NGA), the FERC is obligated to find that any construction or operation of facilities, transportation or sale of natural gas in interstate commerce "is or will be required by the present or future public convenience

and necessary." 15 U.S.C. § 717f(c) and f(e). This duty "requires the Commission to evaluate *all* factors bearing on the public interest." *Atlantic Refining Company v. Public Service Commission (CATCO)*, 360 U.S. 378, 391 (1959); *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 8 (1961). And, no attempt should be made by the agency "to sweep aside the critical safeguards that are embodied in its certification process." *Consumer Federation of America v. FPC*, 515 F.2d 347, 356 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 906 (1975).

In making its public interest finding, the FERC is required to consider the competitive consequences of the proposed new service or facility, *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) *(MPC I); Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) *(MPC II);* and *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (*MPC III*), the possibility of alternatives to the application even if not raised by any protest, and to consider the "reasonably foreseeable future" of the project, *City of Pittsburgh v. FPC*, 237 F.2d 741, 752 (D.C. Cir. 1956). Such a finding must include consideration of the indirect effects of a proposed new service on the ultimate consumers of gas who are the FERC's "prime constituency." *MPC II* at 781. The FERC is not entitled to rest on the record developed by the parties to the proceeding, but must "[act] affirmatively in order to make a complete record." *Scenic Hudson Preservation Conference v. FPC*, 354 F.2d 608, 621 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966).

In adopting the OECP, the FERC turns its back on all of these requirements. As detailed in the Circuit Court opinion, the FERC does not propose to look at any element of an application under the OECP to construct facilities or provide new service which may bypass an LDC except elements detailed in the new regulations. 824 F.2d at 1030, 1031 (App. B-94, 95). These elements relate exclusively to potential financial risk borne by the pipeline applicant. The FERC does not intend to review the impact to others or alternatives to the proposal.

The FERC cannot unilaterally decide to limit its analysis to only two issues; was the customer free contractually to seek bypass, and, did it benefit that customer individually. All other issues cannot be ignored as the FERC has done in approving an OECP application to bypass an existing LDC. *American Distribution Company (Alabama Division)*, 37 FERC ¶61,282 (1986). The "public interest" may not coincide with the interests of the bypassing pipeline and its industrial customer.

The FERC's new policy conflicts with past FERC and court decisions referring to the "long-established" and "well-established" FERC policy "to favor service to industrial customers by local distributors," as opposed to direct pipeline sales or transportation. *See, e.g., Missouri Edison Co. v. FPC*, 479 F.2d 1185 (D.C. Cir. 1973).

Unlike Section 3 of the Natural Gas Act, 15 U.S.C. §717b, the burden of proof concerning the public convenience and necessity under Section 7(c) rests clearly with the applicant. Recently the author of the opinion below noted this fact in upholding the use of rebuttable presumptions pursuant to Section 3. *Panhandle Producers and Royalty Owners Association v. Economic Regulatory Administration*, 822 F.2d 1105 (D.C. Cir. 1987). Unfortunately, this important distinction was not considered in the instant opinion. Indeed, as discussed later, the circuit court opinion provides for a conclusive presumption favoring the applicant as part of a blanket program (OECP) pursuant to Section 7.

The opportunity for specific review of bypass applications which consider all relevent factors is all petitioner seeks. The policy against bypass has never guaranteed distributors that bypass proposals would not be permitted by the Commission in every case, and the preference for service by an LDC would not necessarily apply if case-by-case economic considerations precluded it. *See, e.g., Northern Natural Gas Company*, 33 FPC 501 (1985), and, *Panhandle Eastern Pipe Line Company*, 29 FERC ¶61,338 at 61,709-10 (Dec. 26, 1984). Thus, bypass of an LDC is not favored but may be granted if, after a review of

the facts and relevant policy, the FERC determines that the proposed service would be in the public interest. It has been the traditional and necessary approach of the FERC, mandated by the NGA, which the OECP now drastically alters.

The Circuit Court states that the historic policy disfavoring LDC bypass has been only "the concern over the wasteful construction of duplicative facilities." 824 F.2d at 1038 (App. B-112). To the contrary, the most often cited reason against bypass is the extent to which the loss of large industrial customers of the LDC shifts costs to its remaining customers, particularly captive, small customers. *American Louisiana Pipe Line Co., et al.*, 20 FPC 575 (1958). Other factors supporting the policy against bypass include the fact that LDCs and their ratepayers, as the original pipeline customers, paid most of the cost of construction and maintenance of the facilities and should have a superior right to the pipeline's limited capacity, *Panhandle Eastern Pipe Line Co. v. FPC*, 232 F.2d 467, 472 (3d Cir. 1956), *cert. denied*, 352 U.S. 891 (1956), and, that LDC service, as opposed to pipeline or producer direct service, is subject to greater regulatory supervision.

In neither of the two Notices of Inquiry issued by the Commission in Docket No. RM85-1-000 was the issue of bypass of local distributors, or the Commission's historical policy against such bypass, directly mentioned. Even the NOPR failed to mention this long-honored FERC policy. The Administrative Procedure Act, 5 U.S.C. §553, requires that the agency notice must contain the substance of the proposed rule and may require a description of the issues involved. Failing to mention such a major change to a cornerstore of FERC regulation was inexcusable.

Courts have repeatedly recognized that "the Federal Energy Regulatory Commission 'bears the burden of explaining the reasonableness of any departure from a longstanding practice . . .'" *Public Service Commission of New York v. FERC*, 642 F.2d 1335, 1346 (D.C. Cir. 1980), *cert. denied*, 454

U.S. 879 (1981). The FERC and the Circuit Court, however, fail to give reasoned decisions for the abandonment of the long-standing policy, as pointed out in the dissenting opinion of Judge Mikva on this issue. They can only vaguely refer to FERC's "overall reasoning" for support. 824 F.2d at 1038 (App. B-112). Such a major change requires more support than "overall reasoning" — it needs detailed findings reflecting reasoned decision-making.

II

THE PROCEDURE ESTABLISHED FOR OPTIONAL EXPEDITED CERTIFICATES IS RIPE FOR REVIEW

The OECP, as adopted by the Commission and now approved by the Circuit Court, is ripe for review. The procedure would allow a bypass application to be approved, no matter how unwise and unsupported, as long as the pipeline complies with the new regulations showing that it may bear certain economic risks associated with its own investment. The presumption operates to foreclose all scrutiny of the individual certificate application beyond its compliance with the stated objectives.

To receive a hearing, LDCs and state commissions must raise material issues of fact. These facts must be in addition to arguments concerning the negative impact to the LDC and its customers no matter how devastating. The Circuit Court notes that while the outcome is not necessarily automatic, the FERC "significantly circumscribes its discretion". 824 F.2d at 1032 (App. B-98, 99).

Such material facts must be gleaned from the little information contained in the FERC's notice of the filing and the abbreviated application. No discovery is allowed to determine the impact or defects prior to an FERC order. The protest itself, therefore, is both the first and the last opportunity the adversely affected parties will have to establish their legal and

factual arguments. As stated bluntly in the Notice of Proposed Rulemaking (NOPR), "[t]he protestor shall carry the burden of proof in demonstrating that certification of the proposed activities would not be in the public convenience and necessity." This is despite the fact that the NGA places such a burden firmly on the applicant. 15 USC § 717f(c).

As a practical matter, dismissal by the FERC of the major concerns of LDCs and state commissions as irrelevant makes the "rebuttable" presumption conclusive as to them. Adoption of such a conclusive presumption underscores the ripeness of the issue. Petitioner does not wish to prevent competition; it only desires a meaningful opportunity for a hearing to review *all* the impacts of an application before the FERC makes its decision.

The Circuit Court cites the lack of record evidence to indicate that industrial customers wish to bypass LDCs and that petitioners cannot point to "the slightest hardship." 824 F.2d at 1033 (App. B-102). Due to the long-standing FERC policy against bypass, no such record could be established nor did the FERC even try at that time to establish a record on this point. However, since the issuance of the program and the presumption in favor of bypass, the construction of bypass pipelines and pipeline direct service to industrials has become a constant and disheartening problem for the states and the LDCs. Since the recent inception of this program, many OECP applications have been filed. Some involve minor projects but others involve the construction of hundreds of miles of facilities costing hundreds of millions of dollars. See, *e.g.*, *Iroquois Gas Transmission System*, 51 FR 23267 (June 20, 1987). One OECP application proposes to bypass LDC service through a 1,000-mile-long-pipeline estimated to cost over $665 million. *Wyoming-California Pipeline Co.*, 52 FR 32337, 8 (Aug. 27, 1987). The OECP is significant, substantial, and must be reversed before irreparable damage is done.

III

THIS COURT SHOULD REVIEW TO CLARIFY THE SCOPE OF STATE JURISDICTION OVER TRANSPORTATION WITHIN ITS BOUNDARIES

This Court has noted that the NGA was intended to supplement rather than supplant state regulation. *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950). The House Report to the NGA states that the NGA "takes no authority from State Commissions, and is so drawn as to complement and in no manner usurp State regulatory authority". H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937). *See also; Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 690 (1947).

Key to the Circuit Court's opinion is that the FERC can safely avoid considering impacts to the states, the affected LDC, and the other gas consumers in the state, because the states have the ability to react meaningfully to bypass. 824 F.2d at 1035 (App. B-105). The opinion suggests that the states may exert some sort of certification authority, citing *Panhandle Eastern Pipe Line Company v. Michigan Public Service Commission*, 341 U.S. 329, 336 (1951), or utilize its taxing power to mitigate the impact. 824 F.2d at 1035 (App. B-106). The opinion further, however, declines to rule on the extent of state authority as not in issue or as "too hypothetical". 824 F.2d at 1035, 1037 (App. B-104-106, 109-111). If it is later found that the states lack the authority to take the suggested actions or exert the proposed jurisdiction, then the FERC has created a situation where states and affected LDCs can neither meaningfully complain to the FERC nor take preventive action within the states. That is, if the FERC does not regulate, no one will or can.

There is no record in this proceeding concerning the extent or existence of state authority to address the transportation of natural gas for consumption within a state once it crosses its boundaries nor the ability of such jurisdiction to protect consumers and the public interest. The FERC did not even

attempt to develop such a record. The FERC and the Circuit Court apparently believe that the states can regulate all local concerns. 824 F.2d at 1035 (App. B-106). However, the mere statement by the FERC, and the Circuit Court's implied agreement, that "the states have ample authority to regulate interstate pipelines services that bypass distributors" is not enough. Either this Court must direct the FERC to continue to consider all impacts of bypass on consumers or it must affirm and detail state jurisdiction. Otherwise, a regulatory gap will exist where Congress intended there be none.

The Circuit Court relies on two opinions of this Court for the existence of state authority. *Panhandle Eastern Pipe Line Co. v. Public Service Comm'n of Indiana*, 332 U.S. 507 (1947); *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329 (1951). Those cases do establish that the states may regulate the price at which gas is *sold* by interstate pipelines to end use customers, and that state-level certificates for certain facilities in a bypass proposal may be required, but they do not address *transportation*. Transportation, however, is exactly what the entire FERC Order was intended to foster.

Even if the states can legally regulate bypass to protect the public interest, the FERC has traditionally carried out this responsibility. *See, e.g., FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961); *ANR Pipeline Company*, 34 FERC ¶61,238 (Feb. 20, 1986); *Transwestern Pipeline Company*, 36 FPC 176 (1966). The Commission cannot simply vacate the area without so much as an inquiry into the extent of actual, parallel state regulation. Many state statutes do not provide for regulation of bypass situations (Reply Brief of Associated Gas Distributors, *et al.*, at 5-6), and municipal utilities generally are not subject to state utility commission jurisdiction.

The FERC argues that "where transportation bypass is concerned there is 'a point in time and space' where federal

authority ends and state authority begins." FERC Br. at 162. The Circuit Court decision should be modified to specifically adopt this principle and clarify that state authority, where asserted, exists to enable a state to regulate local distribution and transportation from that "point in time and space" to the end user. As required by Section 1(b) of the NGA, 15 U.S.C. § 717(b), the state thus retains the ability to regulate matters of essentially local concern. *FPC v. East Ohio Gas Co.*, 338 U.S. 464 (1950). This authority of the states applies to "any other transportation or sale. . . or to the local distribution . . . or to the facilities used for such distribution. . ." Section 1(b), Contrarily, the FERC itself, in the context of a bypass proposal, recently indicated that it believes its transportation jurisdiction over pipelines is comprehensive, *ANR Pipeline Company,* 34 FERC ¶61,238, 61,412 (Feb. 28, 1986), including where the application is under the OECP and the Commission has severely restricted its review. *Wyoming-California Pipeline Co.,* 41 FERC ¶61,040 (October 20, 1987). Thus, the FERC wishes to withdraw from exercising its authority but concurrently wishes to prevent state commissions from filling the void or exercising their constitutional authority over "any other transportation" and the "local distribution" of natural gas.

Cases construing the bounds of state vs. federal jurisdiction have repeatedly stressed that Congress intended to leave no "regulatory gaps" and that, if a question arises as to jurisdiction over an area which would be difficult for the individual states to regulate, the federal agency is assumed to have been entrusted to regulate it. *FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 at 28. *See also; Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi,* 474 U.S. 409 (1986). Thus, if the FERC only considers the limited OECP criteria, it is turning its back on the public interest with impunity unless this Court sets aside the Circuit Court determination on this issue or affirms the full extent of state authority.

Further, reference to the taxing power of a state as a remedy to the rate implications of a bypass situation is similarly misguided. 824 F.2d at 1035 (App. B-107). The states will have difficulty taxing any transaction which exclusively involves the interstate transportation of natural gas. *Maryland v. Louisiana,* 451 U.S. 725 (1981). It is difficult to conceive of an example where a tax to mitigate the impact of the bypass transaction would be appropriate or adequate.

IV

THIS COURT SHOULD REVIEW TO PREVENT THE FERC FROM INTERFERING WITH THE LAWFUL EXERCISE OF STATE AUTHORITY

The OECP and its substantive presumption in favor of bypass applications will force the states to modify rate policies or enact new legislation concerning the regulation of the distribution of natural gas for consumption, an area protected from FERC interference by Section 1(b) of the Natural Gas Act. 15 U.S.C. §717(b). The Circuit Court proposes that states face a choice between injuring LDC shareholders, driving industrial customers off the LDC system, or shifting costs to residential consumers. 824 F.2d at 1038 (App. B-110, 111). The states are thus no longer free to develop local policies for the distribution and consumption of gas that do not complement the FERC's new policy. (App. B-126, 127.)

The FERC should, at a minimum, be required to evaluate the impact to all affected groups before making a determination to issue a certificate of public convenience and necessity. Rejecting the OECP does not defeat competition or prevent bypass, it only insures that all essential impacts are evaluated and unwise bypass is identified through complete procedures.

The OECP promotes bypass thereby promoting a segmentation of the gas consumers market analogous to that found

unlawful in the *MPC* cases. When pipelines bypass more and more of an LDC's industrial load, it leaves the small, non-fuel-switchable residential and commercial customers to be served by the LDC. This impact of bypass is not disputed. However, the FERC has stated that policy and factual objections to bypass concerning market distortions caused by an OECP proposal, are foreclosed from consideration, effectively eliminating review of proposals opposed by LDCs or state commissions.

The FERC's support for reduced regulation and competitive forces of the marketplace is commendable. If such actions include abdication of NGA obligations, Congressional action is necessary to relieve the FERC of its responsibilities and the FERC cannot abdicate without such Congressional action. *See, e.g., FPC v. Texaco, Inc.*, 417 U.S. 380, 400 (1974); *Farmers Union Central Exchange, Inc. v. FERC*, 734 F.2d 1486, 1510 (D.C. Cir.), *cert. denied* 469 U.S. 1034.

The Circuit Court further rejects the distinct differences between an LDC's obligation to serve all who desire service, big or little, and that of a bypassing pipeline planning to serve only a select few major customers. The bypassing pipeline under the OECP has no obligation to provide service beyond those it voluntarily assumes. The "raider" simply assumes a potential bypass cost risk and reaps the benefits. In stark contrast, an LDC has an ongoing statutory obligation to serve all new or returning customers desiring service.

Finally, the Circuit Court concludes that only "economic" bypass will occur. All bypass is economic for someone. It may, however, be a disaster to residential and small commercial customers. The impact to all affected consumers and companies is fundamental to determining the true economics. The FERC proposes to look at only one segment of the bypass which is most likely to show "economic benefit" but to ignore those who are certain to suffer and whom the FERC is directed to protect. *CATCO, supra* at 391.

IV

CONCLUSION

This Court should issue its Writ of Certiorari to review the decision of the court below.

Dated: December 10, 1987 Respectfully submitted,

L. E. LoBaugh
T. D. Clarke
E. R. Island
David L. Huard

Attorneys for Southern California Gas Company

Supreme Court, U.S.
FILED
DEC 11 1987
JOSEPH F. SPANIOL, JR.
CLERK

87 1091

No. .....

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

APPENDIX TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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APPENDIX FOR WRIT OF CERTIORARI

TABLE OF CONTENTS

		PAGE
Appendix A	Denial of Rehearing for the United States Court of Appeals for the District of Columbia dated September 15, 1987	A-1
Appendix B	Judgment of the United States Court of Appeals for the District of Columbia Circuit dated June 23, 1987	B-1

No. 85-1811
United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1986

ASSOCIATED GAS DISTRIBUTORS, *et al,*

v.

FEDERAL ENERGY REGULATORY COMMISSION

AND CONSOLIDATED CASES

BEFORE: **Mikva, Bork** and **Williams,** Circuit Judges

ORDER

Upon consideration of the petitions for rehearing of Texas Gas Transmission Corporation, Laclede Gas Company, the Industrial End User Group, the Fertilizer Institute, the Process Gas Consumers Group and the American Iron and Steel Institute, Associated Gas Distributors, and American Public Gas Association, et al., it is

ORDERED, by the Court, that the petitions for rehearing are denied. And it is

FURTHER ORDERED, by the Court, *sua sponte,* that the Clerk is directed to issue the mandate of the Court forthwith. The Court notes that the immediate issuance of the mandate renders moot the Commission's Motion to Allow Interim Rule to Take Effect.

Per Curiam

For The Court:
GEORGE A. FISHER, *Clerk*

By:
ROBERT A. BONNER
Deputy Clerk

Circuit Judge Mikva would grant the petitions for rehearing.

No. 85-1811

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1986

ASSOCIATED GAS DISTRIBUTORS, *et al,*

v.

FEDERAL ENERGY REGULATORY COMMISSION

AND CONSOLIDATED CASES

BEFORE: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg, Bork, Starr, Silberman, Buckley, Williams and D. H. Ginsburg, Circuit Judges

ORDER

The suggestions for rehearing *en banc* of Associated Gas Distributors, et al. and of joint petitioners American Public Gas Association, et al. have been circulated to the full Court. No member of the Court requested the taking of a vote thereon. Upon consideration of the foregoing, it is

ORDERED, by the Court *en banc,* that the suggestions are denied.

Per Curiam

For The Court:
GEORGE A. FISHER, *Clerk*

By:
ROBERT A. BONNER
Deputy Clerk

No. 85-1811

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

SEPTEMBER TERM, 1986

ASSOCIATED GAS DISTRIBUTORS

Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent

AND CONSOLIDATED CASES

BEFORE: Mikva, and Williams, Circuit Judges

ORDER

Upon consideration of the Petition of Michigan Consolidated Gas Company For Stay of Issuance of Mandate and Motion for an Order Retaining Jurisdiction Pending Remand, and Federal Energy Regulatory Commission's Motions to Lodge Agency Order and to Allow Agency Order to Issue, and the responses thereto, it is, for the reasons given in the accompanying memorandum,

ORDERED, by the Court, that the Petition of Michigan Consolidated Gas Company is denied; and, it is

FURTHER ORDERED, by the Court, that the Motions of the Federal Energy Regulatory Commission are granted.

Per Curiam

For The Court:
GEORGE A. FISHER, *Clerk*

Associated Gas Distributors v. Federal Energy Commission, No. 85-1811

MEMORANDUM

On June 23, 1987 this court issued its opinion largely upholding Order No. 436, but vacating the Order in its entirety because certain of its components, which are closely interrelated, suffered from want of legal authority and/or an absence of reasoned decisionmaking. *Associated Gas Distributors v. FERC,* No. 85-1811 (D.C. Cir. June 23, 1987). FERC proposes to respond to the court's opinion by immediately staying the contract demand ("CD") adjustment provisions of the Order, promptly following up with interim regulations, and, ultimately, new final regulations.

We note the concern expressed by numerous parties that natural gas be kept flowing during the period of transition and that uncertainty be minimized to the greatest extent possible. We believe that FERC's proposed course of action reflects an adequate recognition of these concerns and is well within its discretion.

FERC has represented that the purpose of staying the CD adjustment provisions, 18 C.F.R. § 284.10, is to preserve the status quo in a manner consistent with this court's opinion while it fashions interim rules addressing, *inter alia,* the interrelationship between CD adjustment and the take-or-pay problem. By virtue of temporary waivers granted by FERC many pipelines have avoided CD adjustment as a condition to self-implementing transportation under NGPA § 311.[1] The staying of the CD adjustment provisions simply temporarily preserves this status quo.

Moreover, the proposed stay is of a very limited lifespan. FERC has represented that by means of interim regulations (and possibly other related actions) it "will take steps to correct the problems found by the Court with respect to CD adjust-

ments, take-or-pay or grandfathered transportation." Order Staying Effectiveness of Regulation (Docket No. RM85-1-000) at 2-3 (Issued July 2, 1987). Since FERC has not requested a stay of the mandate of our opinion, we take it that FERC plans on issuing the interim regulations in time to avoid creating a regulatory gap.

With the understanding that FERC's interim regulations will issue promptly, and be responsive to the concerns manifested in our opinion, *see Mid-Tex Electric Cooperative, Inc. v. FERC*, No. 86-1414 (D.C. Cir. June 30, 1987), we approve of FERC's proposed course of action, and see no need to withhold issuance of the mandate or to retain jurisdiction over the case.

---

[1] Maryland People's Counsel expresses fears that the proposed stay of the CD adjustment provisions will enable Columbia Gas Transmission Corporation a major pipeline that has elected to operate under Order No. 436, to escape from its election. This appears largely unfounded. As we read FERC's proposed order, all it plans on doing is prospectively staying the CD adjustment provisions. It does not purport to undo elections previously made by Columbia's customers.

OPINIONS OF THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT IN ASSOCIATED GAS DISTRIBUTORS v. FEDERAL ENERGY REGULATORY COMMISSION, No. 85-1811

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1811

ASSOCIATED GAS DISTRIBUTORS,
Petitioner

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent

AIR PRODUCTS AND CHEMICALS, INC., et al.,
ALGONQUIN GAS TRANSMISSION COMPANY,
ALABAMA-TENNESSEE NATURAL GAS COMPANY,
AMERICAN BAKERS ASSOCIATION,
AMERICAN GAS ASSOCIATION,
AMERICAN PUBLIC GAS ASSOCIATION,
AMERICAN PAPER INSTITUTE, INC.,
ARKLA, INC.,
AMOCO PRODUCTION COMPANY,
ARCO OIL AND GAS COMPANY,
ASHLAND EXPLORATION, INC.,
ARMSTRONG WORLD INDUSTRIES,
ASSOCIATED GAS DISTRIBUTORS,
ASSOCIATION OF TEXAS INTRASTATE
NATURAL GAS PIPELINES,
ATLANTA GAS LIGHT COMPANY,
BALTIMORE GAS AND ELECTRIC COMPANY,
BROOKLYN UNION GAS COMPANY,
CABOT CORPORATION,
CAROLINA UTILITY CUSTOMERS ASSOCIATION, INC.,

CASCADE NATURAL GAS CORPORATION,
CENTRAL ILLINOIS LIGHT COMPANY,
CHAMPLIN PETROLEUM COMPANY,
CHEMICAL MANUFACTURERS ASSOCIATION,
CHEVRON U.S.A. INC.,
CITIES SERVICE OIL AND GAS CORPORATION,
CITIZENS ENERGY CORPORATION,
CITY OF WILCOX, ARIZONA and ARIZONA ELECTRIC POWER COOPERATIVE, INC.,
COLUMBIA GAS DISTRIBUTION COMPANIES,
COLUMBIA GAS TRANSMISSION CORPORATION,
COLUMBIA NITROGEN CORPORATION and NIPRO, INC.,
COMMONWEALTH OF KENTUCKY PUBLIC SERVICE COMMISSION,
CONOCO, INC.,
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.,
CONSUMERS POWER COMPANY AND MICHIGAN GAS STORAGE COMPANY,
DELHI GAS PIPELINE CORPORATION,
DEPARTMENT OF PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
DIAMOND SHAMROCK EXPLORATION COMPANY,
EL PASO NATURAL GAS COMPANY,
ENTEX, INC.,
EXXON CORPORATION
FERTILIZER INSTITUTE,
FLORIDA GAS TRANSMISSION COMPANY,
FOOTHILLS PIPE LINES (YUKON) LTD.,
GAS DISTRIBUTORS INFORMATION SERVICE,
STATE OF LOUISIANA,
TENNECO OIL COMPANY,
TENNGASCO CORPORATION,
TEXAS EASTERN TRANSMISSION CORPORATION,
TEXACO, INC.,
TEXAS GAS EXPLORATION CORPORATION,
TEXAS GAS TRANSMISSION CORPORATION,
TRANSCONTINENTAL GAS PIPELINE CORPORATION,
TRANSOK, INC.,

TRANSWESTERN PIPELINE COMPANY,
TRUNKLINE GAS COMPANY,
WEIRTON STEEL CORPORATION,
WESTCOAST TRANSMISSION COMPANY LIMITED,
WEST VIRGINIA CONSUMER ADVOCATE,
WISCONSIN POWER & LIGHT COMPANY,
UNION OIL COMPANY OF CALIFORNIA,
VALERO TRANSMISSION COMPANY,
UNITED DISTRIBUTION COMPANIES,
UGI CORPORATION,
KANSAS POWER AND LIGHT COMPANY,
STATE OF MICHIGAN AND MICHIGAN PUBLIC SERVICE COMMISSION,
SOUTH JERSEY GAS COMPANY,
WASHINGTON GAS LIGHT COMPANY,
ARIZONA PUBLIC SERVICE COMPANY,
SUN EXPLORATION AND PRODUCTION COMPANY,
BETHLEHEM STEEL CORPORATION,
Intervenors

AND CONSOLIDATED CASE NOS. 85-1812, 85-1813, 85-1818, 85-1821, 85-1830, 85-1836, 85-1001, 86-1006, 86-1007, 86-1008, 86-1016, 86-1017, 86-1018, 86-1019, 86-1020, 86-1022, 86-1023, 86-1024, 86-1029, 86-1030, 86-1031, 86-1032, 86-1034, 86-1035, 86-1036, 86-1038, 86-1042, 86-1046, 86-1047, 86-1048, 86-1049, 86-1050, 86-1051, 86-1053, 86-1054, 86-1055, 86-1056, 86-1063, 86-1066, 86-1067, 86-1076, 86-1081, 86-1083, 86-1085, 86-1086, 86-1087, 86-1088, 86-1089, 86-1090, 86-1092, 86-1094, 86-1095, 86-1097, 86-1098, 86-1099, 86-1100, 86-1102, 86-1103, 86-1153, 86-1154, 86-1155, 86-1226, 86-1235, and 86-1246

Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Argued October 14 and 15, 1986

Decided June 23, 1987

Villiam W. Brackett, with whom *David F. Collins* and *Mark Cook* were on the brief for ANR Pipeline Co., al., petitioners in Nos. 86-1055 and 86-1067. *Terry Vogel*, *Jeffrey M. Goldsmith*, and *William M. Lange* ered appearances.

Roberta L. Halladay, with whom *Jerome C. Muys* and *William Cooper* for United Distribution Companies, itioners in No. 86-1006 and intervenors in Nos. 86-11, 86-1016, 86-1067, 86-1087, and 86-1153; *William rfield Ross* and *Daniel Koffsky* for Consumers Power , petitioner in No. 86-1047 and intervenor in No. 85-11, and *Thomas Patrick* and *Karen Cargill* for The ples Gas Light and Coke Co. and North Shore Gas ., petitioners in No. 86-1155 and intervenors in Nos. 1811 and 86-1153, were on the joint brief. *Janet M. bins* for Consumer Power Co., et al. and *Mark Mc-ire* for The Peoples Gas Light and Coke Co., et al. also ered appearances.

John T. Miller, Jr. for Elizabethtown Gas Co., petiner in No. 85-1836.

Robert A. Nelson, Jr. for Northwest Gas Co., with om *Donald K. Darkner* and *Daniel F. Stenger* for CP tional Corp. and *Thomas F. Brosnan* for Washington tural Gas Co. were on the joint brief for petitioners No. 86-1097.

Kenneth J. Nieses for Laclede Gas Co., petitioner in . 86-1001 and intervenor in No. 85-1811.

David B. Robinson, with whom *William J. Guste, Jr.*, torney General, State of Louisiana, and *Theodore L. ues* for State of Louisiana, petitioners in No. 86-1053 d 86-1051 and intervenor in No. 85-1811; *Patrick J. gent*, *James M. Costan*, and *Elisa J. Grammer* for sociation of Texas Intrastate Natural Gas Pipelines, ervenor in No. 85-1811; *J. Paul Douglas*, with whom

Brian J. Heisler and *Kevin Sweeney* for Amoco Gas Co., petitioner in Nos. 86-1081 and 86-1154 and intervenor in Nos. 85-1811, 86-1016, and 86-1055; *C. Burnett Dunn* for Oklahoma Natural Gas Co., intervenor in Nos. 85-1811, 86-1067, 86-1088, and 86-1153; and *William I. Harkaway* for Consolidated Edison of NY, Inc., petitioner in No. 86-1094 and intervenor in No. 85-1811, were on the joint brief. *Timothy Keegan* for Association of Texas Intrastate Natural Gas Pipelines, *Diane Siler* for the State of Louisiana, and *Barbara M. Gunther* and *Steven I. Kalish* for Consolidated Edison of NY, Inc. also entered appearances.

Edward J. Grenier, Jr., with whom *William H. Penniman, Glen S. Howard, Gail S. Gilman, James P. Rathvon,* and *James M. Bushee* for the Process Gas Consumers Group and the American Iron & Steel Institute, petitioners in Nos. 86-1007 and 86-1008 and intervenors in Nos. 85-1811, 86-1226, 86-1235, and 86-1246; *Nicholas W. Fels* and *David N. Heaps* for Air Products & Chemicals, Inc., et al., intervenor in Nos. 85-1811, 86-1016, and 86-1017; *Stephen A. Herman* and *John G. Froemming* for the Fertilizer Institute and American Bakers Association, intervenors in Nos. 85-1811, 86-1016, and 86-1017; *Rigdon H. Boykin* and *Thomas E. Hirsch, III* for American Paper Institute, petitioner in No. 86-1089 and intervenor in Nos. 85-1811, 86-1016, and 86-1017; and *John W. Hardwicke* for Maryland Industrial Group, intervenor in Nos. 85-1811, 86-1016, and 86-1017 were on the joint brief.

Thomas G. Johnson, with whom *M.G. Brookshier* and *Charles McClees, Jr.*, for Shell Offshore, Inc. and Shell Western Electric and Power Inc., petitioner in Nos. 86-1016, 86-1017, and 86-1018 and intervenor in Nos. 85-1811, 85-1812, and 85-1813; *Harris S. Wood* and *Michael G. Maloney* for Arco Oil & Gas Co., intervenor in Nos. 85-1811, 85-1087, and 86-1153; *Thomas J. Eastment* and *Charles M. Darling IV* for Ashland Corp., petitioner in No. 86-1092 and intervenor in No. 85-1811; *Roscoe C. Elmore* for Cabot Corp., intervenor in No.

85-1811; *James B. Atkin, Norma J. Rosner*, and *David J. Evans* for Chevron U.S.A., Inc., petitioner in No. 85-1050 and intervenor in No. 85-1811; *Michael L. Pate* for Cities Service Oil and Gas Corp., intervenor in No. 85-1811; *Ernest J. Altgelt, III* for Conoco, Inc., intervenor in Nos. 85-1811 and 86-1016; *Edmunds Travis, Jr., Glenn H. Mapes, Jr.*, and *Douglas W. Rasch* for Exxon Corp., petitioner in No. 86-1029 and intervenor in No. 85-1811; *John J. Atkins* for Kerr-McGee Corp., petitioner in No. 86-1083; *Gary M. Prescott* for Marathon Oil Co., intervenor in No. 85-1811; *Robert D. Haworth, Jay G. Martin*, and *Thomas George Wagner* for Mobil Oil Corp., et al., intervenors in Nos. 85-1811, 86-1016, 86-1067, 86-1087, 86-1088, and 86-1153; *John B. Chapman, John K. McDonald, Charles E. Suffling*, and *Mary Lee Pieper* for Pennzoil Co., et al., petitioners in Nos. 86-1016 and 86-1103 and intervenors in Nos. 85-1811, 85-1812, 85-1813, and 85-1818; *John L. Williford, Larry Pain*, and *Jennifer A. Cates* for Phillips Petroleum Co., et al., petitioners in No. 86-1087 and intervenors in Nos. 85-1811, 86-1016, 86-1055, and 86-1087; *Ronald D. Hurst* and *Paul W. Hicks* for Placid Oil Co., intervenor in No. 85-1811; *JoAnn P. Russell* for Sohio Petroleum Co., intervenor in No. 85-1811; *Glen E. Taylor, Phillis Rainey*, and *F. Nan Wagoner* for Tenneco Oil Co., petitioner in No. 86-1046 and intervenor in No. 85-1811; *Karen A. Berndt, Ralph J. Pearson, Jr.*, and *David Lindberg* for Texaco, Inc., petitioner in No. 86-1088 and intervenor in No. 85-1811; *B. James McGraw* and *James M. Appelt* for Texas Gas Exploration Corp., intervenor in No. 85-1811; and *Lois Ellen Gold* for Union Oil Co., intervenor in Nos. 85-1811 and 86-1016, were on the joint brief. *Stephen L. Teichler* for Ashland Exploration, Inc., *Paul M. Young* for Cities Service Oil & Gas Corp., *William G. Robb* for Conoco, Inc., *Steven R. Severy* for Marathon Oil Co., *John M. Young* for Pennzoil Co., et al., *Nancy J. Shancke* for Sohio Petroleum Corp., *Albert Sylvia III* for Union Oil Co., of California, and *Joseph G. Stiles* for Exxon Corp. also entered appearances.

Carmen Legato, with whom *Paul J. Kalota*, *Lynn A. Monk*, and *Thomas C. Gorak* were on the brief for Maryland People's Counsel, petitioner in Nos. 85-1813 and 86-1246 and intervenor in Nos. 85-1811, 85-1830, and 86-1016.

Harold L. Talisman with whom *Jeffrey D. Komarow* for Tennessee Gas Pipeline Co., petitioner in No. 85-1821; *Arnold D. Berkeley* and *Richard L. Chaifetz* for the City of Willcox, Arizona and Arizona Electric Power Cooperative, Inc., petitioner in Nos. 86-1016, 86-1099, and 85-1102 and intervenor in Nos. 85-1811, 86-1087, 86-1153, and 86-1226; *Jack H. Cheatman* for Interstate Natural Gas Association of America, petitioner in No. 85-1818 and intervenor in Nos. 85-1811 and 86-1153; *Paul Mallory* for National Gas Pipe Line Company of America, petitioner in No. 86-1153 and intervenor in Nos. 85-1811, 86-1016, 86-1019, 86-1020, 86-1055, and 86-1226; *Raymond N. Shibley* and *Patrick J. Whittle* for Panhandle Eastern Pipeline Corp. and Trunkline Gas Co., petitioners in Nos. 86-1035 and 86-1036 and intervenors in No. 85-1811; *John F. Harrington* for Texas Gas Transmission Corp., petitioner in No. 86-1051 and intervenor in Nos. 85-1811 and 86-1153; *Thomas F. Ryan, Jr.* for Transcontinental Gas Pipeline Corp., petitioner in No. 85-1812 and intervenor in Nos. 85-1811, 86-1019, and 86-1020; and *Richard P. Bonnifield* for Northwest Pipeline Corp., intervenor in No. 86-1032, were on the joint brief. *Michael R. Waller*, *Terence J. Collins*, and *Kathleen T. Puckitty* for Tennessee Gas Pipeline Co.; *Paul E. Goldstein*, *Roy Robertson*, and *Emmitt House* for Natural Gas Pipeline Co. of America; *John B. Rudolph*, *Carol M. Lane*, and *Stephen K. Schroeder* for Northwest Pipeline Corp.; and *William A. Williams* for Texas Gas Transmission Corp., *Robert G. Hardy*, and *Michael J. Fremuth* also entered appearances.

Richard A. Solomon, with whom *David D'Alessandro* and *David E. Blabey* for Public Service of the State of New York, petitioner in No. 85-1830 and intervenor in

Nos. 85-1811, 86-1088, and 86-1153; *Frederick Moring*, *Herbert J. Martin*, and *M. Lisanne Crowley* for Associated Gas Distributors, petitioner in No. 85-1811 and intervenor in Nos. 85-1812, 85-1813, 85-1818, 86-1016, 86-1067, 86-1087, and 86-1088; and *Janice E. Kerr, Jr.*, *Calvin Simpson*, and *Michael B. Day* for Public Utilities Commission of the State of California, petitioner in No. 6-1022 and intervenor in Nos. 85-1811 and 86-1087, were on the joint brief.

William T. Miller and *Susan N. Kelly* were on the brief for American Public Gas Association, petitioner in No. 86-1042 and intervenor in Nos. 85-1811, 86-1067, and 86-1087. *Kathleen A. McKee* also entered an appearance.

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Stephen J. Small and *Ronald N. Carroll* were on the brief for Columbia Gas Transmission Corp., petitioner in No. 86-1023 and intervenor in Nos. 85-1811 and 86-1153. *Richard L. Gottlieb* also entered an appearance.

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Charles D. Gray entered an appearance for National Association of Regulatory Utility Commissioners, petitioner in No. 86-1031.

Dale A. Wright and *James T. McManus* entered an appearance for Northwest Central Pipeline Corp., petitioner in No. 86-1034.

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Byron A. Thomas and *Robert W. Baker* entered appearances for Louisiana Intrastate Gas Corp., petitioner in No. 86-1054 and intervenor in Nos. 85-1811 and 86-1153.

Phillip D. Endom entered an appearance for United Gas Pipe Line Co., petitioner in No. 86-1056.

James G. Beste entered an appearance for Monterey Pipeline Co., petitioner in No. 86-1063.

George J. Meiburger, Frank X. Kelly, and *Steve Stojic* entered appearances for Northern Natural Gas Co., petitioner in No. 86-1066.

Thomas D. Clarke and *David L. Hubard* for Southern California Gas Co., petitioner in No. 86-1076.

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John L. Shailer was on the brief for Columbia Gas Transmission Corp., intervenor in No. 85-1811. *Roger C. Post* entered an appearance.

John T. Ketcham and *Joseph O. Fryxell* entered appearances for intervenors Algonquin Gas Transmission Co. and Cascade Natural Gas Corp. in No. 85-1811.

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Cecil W. Talley entered an appearance for Arkla, Inc., intervenor in Nos. 85-1811, 86-1067, 86-1087, and 86-1153.

Michael W. Hall entered an appearance for Brooklyn Union Gas Co., intervenor in No. 85-1811.

Keith R. McCrea and *James L. Trump* entered appearances for Carolina Utility Customers Association, intervenor in No. 85-1811.

Bernard A. Foster III entered an appearance for Champlin Petroleum Co., intervenor in No. 85-1811.

David F. Zoll entered an appearance for Chemical Manufacturers Association, intervenor in No. 85-1811.

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and Westcoast Thansmission Company Limited, intervenors in Nos. 85-1811, 86-1067, 86-1087, 86-1088, and 86-1153.

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Robert C. Platt entered an appearance for MESA Operating Limited Partnership and Panhandle Producers and Royalty Owners Association, intervenors in No. 85-1811.

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Jerry W. Amos entered an appearance for Piedmont Natural Gas Co., intervenor in No. 85-1811.

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Michael D. Gayda entered an appearance for Southern California Gas Co., intervenor in Nos. 85-1811 and 86-1153.

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Brian J. Moline and *Dana L. Gorman* entered appearances for State Corporation Commission of the State of Kansas, intervenor in No. 85-1811.

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Ralph Simon, Jr. entered an appearance for Transok, Inc., intervenor in No. 85-1811.

Joseph C. Bell entered an appearance for Citizen Energy Corp., intervenor in Nos. 86-1067, 86-1088, and 86-1153.

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Frank H. Strickler and *Gordon M. Grant* entered appearances for Washington Gas Light Co., intervenor in No. 85-1811.

Richard A. Oliver and *Mary Ann Oliver* entered appearances for Weirton Steel Corp. and Bethlehem Steel Corp., intervenors in No. 85-1811.

Denise C. Goulet entered an appearance for West Virginia Consumer Advocate, intervenor in No. 85-1811.

Bruce F. Kiely and *Catherine G. Wakelyn* entered appearances for Wisconsin Power & Light Co., intervenor in No. 85-1811.

M. Frazier King, Jr. and *Thomas George Wagner* entered appearances for Valero Transmission Co., intervenor in No. 85-1811.

Frank P. Saponaro, Jr. and *Jennifer K. Walter* entered appearances for UGI Corp., intervenor in No. 85-1811.

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Joseph M. Oliver entered an appearance for South Jersey Co., intervenor in No. 85-1811.

David L. Konick entered an appearance for Brooklyn Union Gas Co., intervenor in No. 86-1067 and 86-1087.

John F. Povilaitis and *Charles F. Hoffman* entered appearances for Pennsylvania Public Utility Commission, intervenor in Nos. 86-1087 and 86-1153.

William B. Gundling, *Simon Lazarus*, and *Clement R. Gagne III* entered appearances for State of Connecticut and Northern Valley Environmental Council, *amici curiae* in No. 85-1811.

Before: MIKVA, BORK, and WILLIAMS, *Circuit Judges*.

Opinion for the Court filed by *Circuit Judge* WILLIAMS.

Opinion concurring in the judgment in part and dissenting in part filed by *Circuit Judge* MIKVA.

WILLIAMS, *Circuit Judge*:

TABLE OF CONTENTS

	Page
I. INTRODUCTION	17
A. Parties	18
B. Regulatory and Economic Context	20
II. OPEN-ACCESS REQUIREMENTS	24
A. Claimed Deficiencies in Statutory Authority to Require Open Access	24
1. Natural Gas Act	25
2. Natural Gas Policy Act	34
B. Alleged Failure to Comply with Mandate of Outer Continental Shelf Lands Act	39
C. Claims of Arbitrariness and Caprice	41
1. Failure to impose the nondiscriminatory access conditions on § 7(c) transportation certificates	41
2. Capacity allocation on a "first-come, first-served" basis	42
III. RATE CONDITIONS	47
A. Absence of Finding that Prior Rates Were Unlawful	48
B. Allowance of Discounting Generally	50
C. Potential Discrimination Between Bundled and Unbundled Transportation	51
D. Selective as Opposed to Uniform Discounts	52
E. Consistency of "Value-of-Service" Discounting with *MPC II*	53
F. Impact of Discounting on Pipeline Solvency	56
IV. CONTRACT DEMAND ("CD") ADJUSTMENT	58
A. Legal Authority	61
1. Violation of *Panhandle* doctrine	61
2. Alleged lack of compliance with § 7(b)	63
B. Adequacy of the Commission's Reasoning in Support of CD Conversion	65
C. Adequacy of the Commission's Reasoning in Support of CD Reduction	70
D. Insufficiency Under *MPC III*	73

Page

V. PRODUCER-PIPELINE CONTRACTS ---------- 75

A. The Commission's Prior Activity and Its Inactivity in This Proceeding ---------- 77

B. Analysis of FERC's Decision ---------- 81

1. Lack of need for additional steps ------ 81

a. Likely effects of Order No. 436 on take-or-pay build-up ---------- 81

b. Pipeline ability to shift costs downstream ---------- 85

2. Policy considerations militating against any intervention ---------- 87

3. Reasons for rejection of specific proposals ---------- 89

a. Section 5 action against jurisdictional contracts ---------- 89

b. Conditioning producer access ------ 91

C. Conclusion ---------- 95

VI. OPTIONAL EXPEDITED CERTIFICATION ---------- 95

A. Ripeness ---------- 97

B. Legality of the Presumption ---------- 103

1. Alleged disregard of legally relevant factors ---------- 103

2. Unsupported assumptions ---------- 111

3. Alleged failures of reasoned decisionmaking ---------- 112

VII. MISCELLANEOUS ARGUMENTS ---------- 113

A. Pipeline Sales Service Issues ---------- 113

B. Notice Provisions ---------- 114

C. Transportation Policies ---------- 115

D. Construction of Facilities for Use in § 311 Transportation ---------- 115

E. Grandfathering Decisions ---------- 117

F. System Supply Limitation ---------- 120

G. Transportation for Fuel-Switchable End Users ---------- 122

VIII. CONCLUSION ---------- 124

I. INTRODUCTION

On October 9, 1985 the Federal Energy Regulatory Commission ("FERC" [1]) issued Order No. 436, 50 Fed. Reg. 42,408 (1985) (codified at scattered sections of 18 C.F.R.). The Order envisages a complete restructuring of the natural gas industry. It may well come to rank with the three great regulatory milestones of the industry: the passage of the Natural Gas Act, 15 U.S.C. §§ 717 *et seq.* (1982) ("NGA") in 1938, the imposition of price controls on independent producers' wellhead sales under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), and adoption of the Natural Gas Policy Act ("NGPA"), 15 U.S.C. §§ 3301 *et seq.* (1982) in 1978.

At stake is the role of interstate natural gas pipelines. Although they are obviously transporters of gas, they have until recently operated primarily as gas merchants. They buy gas from producers at the wellhead and resell it, mainly to local distribution companies ("LDCs") but also to relatively large end users. The Commission has concluded that a prevailing pipeline practice—particularly their general refusal to transport gas for third parties where to do so would displace their own sales (Joint Appendix ("J.A.") 318-19)—has caused serious market distortions. It has found this practice "unduly discriminatory" within the meaning of § 5 of the NGA. Order No. 436 is its response.

The essence of Order No. 436 is a tendency, in the industry metaphor, to "unbundle" the pipelines' transportation and merchant roles. If it is effective, the pipelines will transport the gas with which their own sales

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[1] References to the Commission also include its predecessor, the Federal Power Commission, where appropriate. *See* Executive Order No. 12,009, 42 Fed. Reg. 46,267 (1977) (implementing portions of Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 (1977), terminating the FPC and transferring its duties to FERC, an independent agency within the Department of Energy).

compete; competition from other gas sellers (producers or traders) will give consumers the benefits of a competitive wellhead market.

Virtually every sector of the natural gas industry has challenged the Order, asserting a dazzling array of errors and omissions. They have filed some 85 briefs totaling about 2,000 pages. Oral argument spanned two days in a well-filled courtroom.[2] We here uphold most elements of the Order, but remand the case to the Commission on certain issues.

A. *Parties.*

The bulk of the petitions for review are filed by representatives of the main actors in the industry: (1) producers, (2) pipelines, (3) LDCs and (4) end users. A word follows as to the varieties and regulatory status of each, and as to the developments underlying the Commission's decision.

Producers are primarily independents, in the sense of being unaffiliated with any pipeline. Pipelines and pipeline affiliates produce only about 11% of the gas sold by pipelines in the interstate market. Interstate Natural Gas Ass'n of America, "The Gas Contracts Problem: Results of an INGAA Survey" 13 (Policy Analysis 83P-1, May 1983) (cited at J.A. 301 n.34; data for 1982). The producers typically operate under oil-and-gas leases with owners of the land or mineral interests, subject to a duty to pay royalty and at some risk of losing their leases if production ceases.

Producers' interstate wellhead sales have, through the operation of law or economics, achieved virtually complete

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[2] A lawyer in the natural gas industry once urged that the only beneficiaries of the *Phillips* decision were lawyers. *See* C. Hawkins, *The Field Price Regulation of Natural Gas* 205 (1969). The fallout from that decision appeals still to provide a rich lode.

release from binding price controls. The NPGA provided this almost immediately for certain categories of "high cost" gas. NGPA § 121(b), 15 U.S.C. § 3331(b) (1982). For most "new" gas, the NGPA established new ceilings, higher than those previously set by the Commission, and provided for gradual increases until scheduled deregulation on January 1, 1985 or July 1, 1987. NGPA §§ 102, 103, 121(a) & (c), 15 U.S.C. §§ 3312, 3313, 3331(a) & (c) (1982). In fact, current market prices at the wellhead are significantly below the ceilings remaining in these categories. *Compare Selected National Average Natural Gas Prices*, Natural Gas Monthly 10 (Jan. 1987) (average price at wellhead for March 1986 $2.16) *with Natural Gas Ceiling Prices by Category of Gas, Type of Sale, or Contract*, Natural Gas Monthly 30 (Jan. 1987) (ceiling price for § 102 and § 103 gas for same period ranged from $3.083 to $4.216). The NGPA made no provision for deregulation of "old" interstate gas, but, besides allowing escalation to reflect general price inflation, authorized the Commission to raise the former ceilings to higher "just and reasonable" levels. (The Commission actually exercised this authority on June 6, 1986, in Order No. 451, III FERC Status & Regulations ¶ 30,701, at 30,197 (1986).)

The pipelines are either intrastate or interstate. Since enactment of the NGA, the interstate pipelines have been subject to pervasive Commission regulation. Before performing any significant act—construction of new facilities or initiation of new transportation service or new sales for resale—they must secure a certificate of convenience and necessity from the Commission. NGA § 7(c), 15 U.S.C. § 717f(c) (1982). They also require Commission approval when they abandon any "certificated" facility, transportation or sale. NGA § 7(b), 15 U.S.C. § 717f(b) (1982). Finally, the Commission limits to "just and reasonable" levels the prices at which the interstates sell gas for resale or provide transportation service. NGA § 4(a), 15 U.S.C. § 717c(a) (1982). Under conventional

public utility principles this allows the pipelines, at least in theory, to recover no more than cost of service, including a reasonable return on investment.

LDCs purchase gas for resale to end users, large and small. Their services and prices are subject to state regulation but not to that of FERC.

End users run the gamut both in size and in ability to use substitutes. At one end is the ordinary householder, who even in the intermediate run in limited to such expedients as installing better insulation, wearing more sweaters, or turning the thermostat down. At the other end of the spectrum are users that need only flick a switch to replace gas with oil.

B. *Regulatory and Economic Context.*

The Natural Gas Act has the fundamental purpose of protecting interstate gas consumers from pipelines' monopoly power. *See* Sen. Doc. No. 92, part 84A, 70th Cong., 1st Sess. 588-91 (FTC Utility Corporations Rep. 1935). By the early 1980s, a number of developments suggested, for the first time since enactment, that assuring customer access to the wellhead market could be an important potential ingredient in Commission fulfillment of that goal. First, by then a nationwide pipeline network had matured. J.A. 279, 284-92. This made it physically possible, for the first time, for consumers to acquire gas supplies from virtually any region. It also ended, or at least sharply reduced, pipeline monopsony power over wellhead purchases, a power that had the tendency to keep wellhead prices below competitive levels. *See* S. Breyer, *Regulation and its Reform* 243 (1982); *cf.* Note, *Federal Price Control of Natural Gas Sold to Interstate Pipelines*, 59 Yale L.J. 1468, 1478-79 (1950).

Second, the removal of wellhead price controls greatly increased an underlying risk of the regulatory system—that pipelines' gas purchase costs would rise above competitive market levels. For while cost-based price regula-

tion at least in principle prevented pipelines from enjoying monopoly profits, the combination of market power and regulation tended to blunt their incentives for careful gas purchasing. The pipelines' market power dampened any fear of being unable to recover exorbitant costs; regulation dampened any hope of direct profit from thrifty purchases, as it prevented them from making any mark-ups not based on cost. *Cf. Pierce, Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 345, 357-65 (1983). As it proved, this lulling effect of regulation—coupled with the gyrations of the energy market from 1973 to the present—brought on the phenomenon of embedded contract prices well above competitive levels at the wellhead. For example, the Commission has recently estimated average prices paid by pipelines at the wellhead at about $2.50 per thousand cubic feet ("Mcf"), compared with less than $2 per Mcf in the spot market. *See* Order No. 451, III FERC Statutes & Regulations ¶ 30,701, at 30,210 (1986). (If the volume of the interstate market is about seven trillion cubic feet ("Tcf"), this would amount to a $3.5 billion price discrepancy.) The Commission's estimate of the price specified in long-term new contracts as of mid-1986 was about the same as the average price then being paid by the pipelines (about $2.50), *see id.*; but the pipelines attained their figure for average price actually *paid* in part by refusing to take high-priced gas and thus subjecting themselves to a build-up of very substantial take-or-pay liability (discussed immediately below).

Third, the conditions under which the NGPA began to relax wellhead price controls—namely acute gas shortage and sharply rising prices for alternative fuels—tended to divert pipeline attention from the hazards of incurring long-term obligations to buy high-priced gas. Under pressure from the Commission, the pipelines had typically purchased gas under contracts for very long terms. *See, e.g.*, 18 C.F.R. § 2.61 (requiring pipelines to maintain

supply reserves of up to 12-years' projected demand); *Columbia Gas Transmission Corp.*, 21 F.E.R.C. ¶ 61,026, at 61,160-61 (1982) (example of long-term supply arrangements pipeline must make in order to extend new service); Department of Energy, *The First Report Required by Section 123 of the National Gas Policy Act of 1978* 3-2 (1984) (producer-pipeline contracts for 10 or more years are common). Besides incorporating high prices (and provisions for escalation upward), the contracts commonly included "take-or-pay" provisions, requiring the pipeline to pay for some specified percentage, say 75%, of the deliverable gas even if it took less. While usually subject to recoupment later, and while a perfectly natural allocation of risk between producer and purchaser, the take-or-pay provisions effectively committed the pipelines to high gas costs in what by 1982 proved to be a time of falling prices, both for competing fuels and for substitute supplies of gas not covered by contract.

Fourth, various economic forces, including exhaustion of the cheaper supplies and the decline of pipeline monopsony at the wellhead, *see* S. Breyer, *Regulation and Its Reform* 243 (1982), raised the wellhead price—and thereby the potential loss to consumers if they should be saddled with the results of pipelines' readiness to bid high prices. After hovering in the range of $.50 (in constant 1984 dollars) per million British thermal units ("Btu") from 1930 to 1973, it rose to over $2.50 by 1982. *See* Energy Information Administration, *An Analysis of the Department of Energy's Notice of Proposed Rulemaking (NOPR), "Ceiling Prices: Old Gas Pricing Structure"* 3 (1986). While the wellhead price in 1972 represented only about 28% of the delivered price to consumers, by 1981 that fraction had risen to 57%. *Id.* at 5.

These developments lie in the background of the key Commission findings in support of Order No. 436. (1) Despite the growth of a competitive wellhead market, the

interstate pipelines retain market power in gas transportation. J.A. 306. (2) Pipelines have generally declined to transport gas in competition with their own sales (except for transportation to customers that can switch to alternative fuels at little or no extra cost). J.A. 318-19. (3) Pipeline discrimination in transportation has denied consumers access to gas at the lowest reasonable rates. J.A. 320, 352.

Thus the early 1980s created the likelihood, for the first time, that the Commission could best fulfill the purposes of the NGA by adopting rules enabling customers to buy gas at the wellhead and to overcome the interstate pipelines' general refusal to move gas that would compete with their own sales. Besides protecting consumers from the burden of the pipelines' purchase contracts at supra-market prices, such rules would have the long-term effect of subjecting pipelines to the ordinary constraints of a middleman under competitive conditions. This the Commission set out to achieve in Order No. 436.

The Order's regulatory package includes these elements: (1) If a pipeline seeks to take advantage of "blanket certification" of transportation (*i.e.*, a certificate authorizing transportation services generically and thus obviating the need for unwieldy individual certification), it must commit itself to provide transportation on a nondiscriminatory basis (and thus become an "open-access" pipeline). (2) When demand outruns capacity for open-access transportation, the open-access pipeline shall allocate capacity on a "first-come, first-served" basis. (3) Rate regulation for open-access transportation will take the form of ceilings and floors, with the pipeline free to adjust rates within that band. (4) Any open-access pipeline, by applying for certification, agrees to allow its LDC customers to convert their "contract demand" ("CD") (*i.e.*, contract commitment to purchase gas) from an obligation to purchase gas to an obligation to use (or pay for) transportation services. The point of

the option is to make open access a reality for the pipelines' LDC customers despite long-term contractual service arrangements previously certificated by the Commission. The Order also requires an open-access pipeline to give its LDC customers the option to reduce contract demand. (5) The Commission will issue "Optional, Expedited Certificates" for new facilities, services and operations where the pipeline undertakes the entire economic risk of the project. The Commission declined to include in the package any special provision to relieve pipelines from the burden of take-or-pay contracts providing for prices well above current competitive levels.

Each component of the package contains many details not given above, some of them the source of challenges in this case. The details will be developed as appropriate in the opinion.

II. Open-Access Requirements

A. *Claimed Deficiencies in Statutory Authority to Require Open Access.*

Order No. 436 imposes an "open-access" commitment on any pipeline that (1) secures a "blanket certificate" to provide gas transportation, pursuant to § 7 of the NGA, 15 U.S.C. § 717f (1982), or (2) actually provides transportation under § 311 of the NGPA, 15 U.S.C. § 3371 (1982). *See* 18 C.F.R. §§ 284.8(b), 284.9(b).[3] Several pipelines and others attack these conditions as beyond the scope of the Commission's authority under the two statutes. The arguments under both statutes rely on the proposition that the "open-access" condition is equivalent to a "common carriage" requirement, as both the condition and common carriage have at their core a duty to accept shipments from all would-be shippers. The two

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[3] Except where indicated otherwise all citations to the Code of Federal Regulations are to the 1986 edition.

statutes differ radically in their languages, however, so we treat the claims separately, rejecting both.

1. *Natural Gas Act.*

The pipelines can point to no language in the NGA barring the Commission from imposing common carrier status on natural gas pipelines, and certainly none barring it from imposing upon the pipelines a specific duty that happens to be a typical or even core component of such status. They seek to overcome the statutory silence by means of legislative history. The task is uphill; "courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point." *IBEW, Local No. 474 v. NLRB*, 814 F.2d 697, 712 (D.C. Cir. 1987) (emphasis deleted) (citing *United States v. American College of Physicians*, 106 S. Ct. 1591, 1598 (1986)).

The legislative history here consists entirely of congressional inaction. In 1906, when Congress brought oil pipelines under the wing of the Interstate Commerce Commission, it amended the Interstate Commerce Act to exclude natural gas pipelines from the category of common carrier, thus making clear that they were not covered by the extension of jurisdiction. Pub. L. No. 59-337, § 1, 34 Stat. 584, 584 (codified as amended at 49 U.S.C. §§ 10,102, 10,501 (1982)). In 1913 a bill was introduced in the Senate that would have reversed the 1906 decision, *see* S. 3345, 63d Cong., 2d Sess., 50 Cong. Rec. 5847-49 (1913), but it was never enacted. Finally, in 1935 a bill presaging the NGA—similar to the ultimate statute but explicitly imposing common carrier duties—died in committee. *See* H.R. 5423, 74th Cong., 1st Sess., 70 Cong. Rec. 1624 (1935).

This history provides strong support only for the point that Congress declined itself to impose common carrier status on the pipelines—a proposition that is unquestioned and is evident from the language of the statute

itself. The chain of inference gets steadily weaker as we move toward more relevant issues. The history supplies modest support for the view that Congress did not intend the Commission to impose common carriage conditions at will. It affords weak—almost invisible—support for the idea that the Commission could under no circumstances whatsoever impose obligations encompassing the core of a common carriage duty.

The weakness of the legislative history is underscored when we examine the very component of "common carriage" on which the challenging pipelines rest their case: the duty to carry without discrimination. Insofar as they argue that a concern about discrimination has been a driving force behind legislative imposition of common carriage regulation, history is on their side. *See, e.g., Louisville & Nashville R.R. v. United States*, 282 U.S. 740, 749-50 (1931); L. Gorton, *The Concept of the Common Carrier in Anglo-American Law* 42-43 (1971). But in the NGA Congress affirmatively addressed itself to that issue, giving the Commission power to stamp out undue discrimination; it is precisely that power that the Commission has here sought to exercise.

The Act fairly bristles with concern for undue discrimination. Section 4 prohibits any "undue preference" and any "unreasonable difference in rates, charges, service, facilities, or in any other respect," and empowers the Commission to review tariffs filed by pipelines in order to reject ones violating the prohibition. 15 U.S.C. § 717c (1982). Section 5—the primary authority invoked by the Commission here—directs the Commission to adopt corrective measures whenever it finds a "rate, charge or classification," or any "rule, regulation, practice, or contract" affecting the same, to be "unjust, unreasonable, unduly discriminatory, or preferential." *Id.* § 717d.

The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage

regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress, in 1906 and 1914 and 1935 and 1938 itself, refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.

Thus we find little relevance in cases relied on by the pipelines for the proposition that a duty to provide service to all comers is the essence of common carriage. In each of those cases the court was construing the term as used in a statute, in one instance stating that a particular class of persons "shall not . . . be deemed a common carrier," *FCC v. Midwest Video Corp.*, 440 U.S. 689, 699-702 (1979), in the others prohibiting agency exercise of jurisdiction over activities of certain persons classified as common carriers, *see National Ass'n of Regulatory Utility Commissioners v. FCC*, 525 F.2d 630 (D.C. Cir. 1976); *National Ass'n of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601 (D.C. Cir. 1976). Such cases are not helpful on the issue of whether Congress's omission of the term common carrier significantly undercuts its explicit provision of authority to prevent or correct undue discrimination.

Petitioners cite *Florida Power & Light Co. v. FERC*, 660 F.2d 668 (5th Cir. 1981), and *Richmond Power & Light v. FERC*, 574 F.2d 610 (D.C. Cir. 1978), for the following proposition: that any order by the Commission conditioning its approval of any "wheeling" (*i.e.*, transmission of electricity owned by another) on the utility's agreement to wheel for all constitutes an attempt by the Commission to impose indirectly duties that the Federal Power Act prevents it from imposing directly, namely

common carriage. As the Federal Power Act establishes a regulatory scheme for electricity paralleling that which the NGA creates for gas, *see, e.g., FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956), petitioners contend that the *Richmond* and *Florida* cases compel invalidation of the Comission's open-access condition.

We think petitioners read *Richmond* and *Florida* far too broadly. First, we note that the legislative history of the two acts is, on this point, materially different. In its deliberations on the bill that ultimately emerged as the Federal Power Act, Congress considered and rejected a provision that would have "empowered the Federal Power Commission to order wheeling if it found such action to be 'necessary or desirable in the public interest.'" *Otter Tail Power Co. v. United States*, 410 U.S. 366, 374 (1973) (quoting S. 1725, 74th Cong., 1st Sess.). The evidence as to the NGA (surveyed above) is less direct: it consists exclusively of various occasions on which Congress did not adopt proposals actually making the natural gas pipelines into common carriers.

Second, neither *Richmond* nor *Florida* comes anywhere near stating that the Commission is barred from imposing an open-access condition in all circumstances. In *Florida*, the court expressly left open the question whether the Commission would be entitled to use open-access conditions as a remedy for anti-competitive conduct. 660 F.2d at 677-79. It stressed the failure of the Commission, in the orders under review, to "make any findings of anti-competitive activities or violations." *Id.* at 678. Evidently because no party raised the issue, the court did not address the Commission's power to exact such conditions as a remedy for undue discrimination. *Cf. FPC v. Conway Corp.*, 426 U.S. 271, 276-77 (1976) (accepting assumption that the Commission could not remedy a utility's discrimination between wholesale (jurisdictional) rates and retail (nonjurisdictional) rates by ordering increases in the latter).

In *Richmond* the Commission had repulsed Richmond Power & Light's demand that it condition approval of any transmission by either of two large interstate systems on their agreeing to transmit for all. In upholding the Commission we said little more than that unwillingness to transmit for all comers could not be automatically deemed an undue discrimination:

> Thus Richmond spurned the opportunity to demonstrate that particular activities were unreasonably anticompetitive or discriminatory and claimed instead that the mere failure to wheel energy to and from Richmond while wheeling for any other utility was unlawful discrimination.

574 F.2d at 623. We went on to say that the Commission's rejection of a *per se* rule (*i.e.*, a rule that selective transmission was necessarily undue discrimination) followed logically from Congress's refusal to impose common carrier duties on electric utilities. *Id.*

Petitioners' reading of *Richmond*, moreover, is belied by this court's later decision in *Central Iowa Power Coop. v. FERC*, 606 F.2d 1156 (D.C. Cir. 1979). Pursuant to § 205 of the Federal Power Act, 15 U.S.C. § 824d (1982) (paralleling § 4 of the NGA), the Commission had reviewed the terms of a power-pooling agreement that established two classes of membership, one of them entitled to fewer privileges than the other. Finding the distinction discriminatory on its face, the Commission conditioned its approval on removal of the membership criteria that prevented the inferior class of participants from enjoying the privileges of the favored ones. We upheld the decision as a proper exercise of its power to prevent undue discrimination. 606 F.2d at 1170-72. *See* Reiter, *Competition and Access to the Bottleneck: The Scope of Contract Carrier Regulation Under the Federal Power and Natural Gas Acts*, 18 Land & Water L. Rev. 1, 47-50 (1983). The Commission's open-access condition relies on precisely that principle.

It is true that in *Central Iowa* the court rejected South Dakota's claim that the Commission should have conditioned approval of the power-pooling agreement on the parties agreeing to wheel for nongenerating electrical systems. *See* 606 F.2d at 1169. Such a condition would in effect have forced on the participants a broad extension of their agreement to wheel for each other. *See id.* at 1160 n.7. Though the court brushed the request aside in fairly sweeping language, its approval of the Commission's elevation of the inferior class of members clearly limits the negative impact of the discussion. The case upholds the power of the Commission to subject approval of a set of voluntary transactions to a condition that providers open up the class of permissible users.

Neither *Florida* nor *Richmond* presented the extreme factual circumstances that are now present in the gas industry. Here the Commission has found (a) that pipelines continue to possess substantial market power, J.A. 306; (b) that they have exercised that power to deny their own sales customers, and others without fuel-switching capability, access to competitively priced gas, J.A. 318; and (c) that this practice has denied consumers access to gas at the lowest reasonable rates, J.A. 318-21, 352. Thus, despite the removal of regulation over the price and non-price aspects of wellhead transactions, and the evolution of an interconnected nationwide pipeline grid, discrimination in transportation has denied gas users, and the economy generally, the benefits of a competitive wellhead market.

Despite a sweeping suggestion that the Order is "unsupported," Brief of Interstate Pipeline Group at 35, the pipelines do not in fact challenge these factual findings. Their objection is rather on matters of policy, grounded on beliefs that the kind of discrimination here prohibited is not "undue" within the meaning of the NGA.[4] Indeed,

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[4] Attacks on the Order for failure to take account of preferences based on pipeline contracts with particular customers are

the burden of their attack on the Order is precisely that it may disable them from passing on to customers gas purchase costs that they incur under contracts entered into years ago under premises now obsolute. *Id.* at 37-38. In other words, enforcement of Order No. 436 will expose them to competition that their discriminatory practices enable them to avoid. Their claim thus tends to substantiate the Commission's views (1) that in the absence of Order No. 436 competition will be thwarted and (2) that the practices controlled by Order No. 436 are indeed anticompetitive and discriminatory.

The electricity cases cited thus provide only very weak support for the challenge. In contrast, our decision in *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*"MPC II"*), came about as close to endorsing the Commission's approach as Article III permits. There we vacated orders of the Commission that had established "blanket certificate" transportation *without* any specific effort to prevent pipelines from offering such transportation on a discriminatory basis. We did not, of course, explicitly find "undue discrimination" such as would obligate the Commission to act under § 5. But we did find that the petitioners there had made a strong enough showing to require the Commission to address the issue. Specifically, we made it clear that blanket-certificate transportation, unconstrained by any nondiscriminatory access provision, might well require remedial action under § 5. We ended by saying:

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discussed below in consideration of problems of capacity allocation. *See infra* part II.C.2. Insofar as the pipelines claim that prohibitions of undue discrimination must be based upon *individualized* findings, the cases on which they rely, *American Smelting & Rfg. Co. v. FPC*, 494 F.2d 925, 939-41 (D.C. Cir.), *cert. denied*, 419 U.S. 882 (1974); *Louisiana Power & Light Co. v. FPC*, 526 F.2d 898, 905-07 (5th Cir. 1976), are plainly inapposite. *See Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1165-68 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986).

> We vacate the challenged orders to the extent that they allow transportation of direct-sale gas to fuel-switchable, non-"high-priority" end users without requiring pipelines to furnish the same service to LDCs and captive consumers on nondiscriminatory terms.

761 F.2d at 789 (footnote omitted).

Our holding in *MPC II* obviously did not require the Commission to make the findings that it has. It surely carried the implication, however, that if it did make supportable findings of undue discrimination in pipeline use of the old blanket certificates, it would have the authority to employ suitable remedies. And it carried the further implication that among them might be a requirement that any pipeline offering blanket-certificate transportation agree to serve "LDCs and captive consumers on nondiscriminatory terms." *Id.*

The interstate pipelines appear to suggest that Order No. 436's impact on their financial integrity is so grave as to be equivalent to a rule denying them the legal right to pass on costs, and invalid as such a rule would be. It is true that the Commission has only very limited power to deny the pipelines the *legal* right to pass gas purchase costs through to customers. *See* § 601(c)(2) of the NGPA, 15 U.S.C. § 3431(c)(2) (1982) (providing that the Commission must allow interstate pipelines to pass through gas costs not violating NGPA wellhead ceilings "except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds"); *Office of Consumers' Counsel v. FERC*, 783 F.2d 206 (D.C. Cir. 1986). But petitioners have called our attention to nothing that bars the Commission from devising rules that remedy a lack of competition by exposing pipelines to competition and its normal consequences. The Supreme Court has made clear, for example, that the due process clause affords no protection

from losses inflicted by market conditions. In *Market Street Ry. v. Railroad Comm'n*, 324 U.S. 548 (1945), it said of its decision in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944):

> All that was held was that a company could not complain if the return which was allowed made it possible for the company to operate successfully. There was no suggestion that less might not be allowed when the amount allowed was all the company could earn. . . . The due process clause . . . has not and cannot be applied to insure values or to restore values that have been lost by the operation of economic forces.

324 U.S. at 566-67. Similarly, nothing in the NGA protects the pipelines from the market forces to which Order No. 436 subjects their gas marketing business, even though those forces are derived in part from a restriction on their discrimination in transportation.

It is finally argued that the Commission's not having imposed any requirements like those of Order No. 436 in the period from enactment in 1938 until the present demonstrates the lack of any power to do so. *Cf. FPC v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513-14 (1949). But as our introductory review of the economic background sought to illustrate, the Commission here deals with conditions that are altogether new. Thus no inference may be drawn from prior non-use.

While the Supreme Court's decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), it is not a wand by which courts can turn an unlawful frog into a legitimate prince, the case bolsters our conclusion. Congress has given the Commission in § 5 of the NGA a broad power to stamp out undue discrimination; in § 7 the power to approve certificates of service subject to "such reasonable terms and conditions as the public convenience and necessity may

require"; and in § 16 the power to "perform any and all acts, and to prescribe . . . such orders, rules, and regulations as it may find necessary or appropriate to carry out the [NGA's] provisions." The alleged negative restriction on this power is at best ambiguous, if indeed it exists at all. Under these circumstances, *Chevron* binds us to defer to Congress's decision to grant the agency, not the courts, the primary authority and responsibility to administer the statute. The Commission's view represents "a reasonable interpretation" of the Act, for which we may not substitute our view. 467 U.S. at 844.

2. *Natural Gas Policy Act.*

In enacting the NGPA Congress endeavored to break down the regulatory barriers between the interstate and intrastate markets. Sections 311 and 602(b)(2) were added to "facilitate[] development of a national natural gas transportation network without subjecting intrastate pipelines, already regulated by State agencies, to FPC regulation over the entirety of their operations." H.R. Rep. No. 543, 95th Cong., 1st Sess. 45 (1977). *See also Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342-43 (1983). Thus, § 311(a) permits the Commission to authorize transportation by an interstate pipeline on behalf of an intrastate or LDC and by an intrastate on behalf of an interstate or LDC. 15 U.S.C. § 3371(a) (1982). The Commission has exercised this authority, permitting such transportation as a general matter. *See* 18 C.F.R., part 284, subparts B and C. It has also exercised the authority provided by § 311(c), 15 U.S.C. § 3371(c) (1982), to prescribe terms and conditions.[5] Order No. 436 would add to these the requirement that any interstate or intrastate pipeline offering such transportation shall do so on a nondiscriminatory basis. 18 C.F.R. §§ 284.8(b) and 284.9(b). Petitioners challenge these open-access conditions, relying here on

[5] "Any authorization granted under this section shall be under such terms and conditions as the Commission may prescribe." *Id.*

express statutory language. Section 602 of the NGPA, captioned "Effect on State Laws," provides in subsection (b):

> (b) Common carriers.
>
> No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—
>
> (1) pursuant to any order under section 3362 (c) or section 3363(b), (c), (d), or (i) of this title; or
>
> (2) authorized by the Commission under section 3371(a) of this title [section 311(a) of the NGPA].

15 U.S.C. § 3432(b) (1982).

Petitioners read this language as stultifying any effort by the Commission to control discrimination where that effort imposes on pipelines a duty—even though it be a conditional one—equivalent to the common carrier's duty to provide nondiscriminatory service. We believe this interpretation is incorrect.

It seems to us that § 602(b)(2) was a congressional effort to protect § 311(a) from the consequences of pipeline concern that service thereunder would expose them generally to classification as common carriers, most likely by states, and thus to an unprecedented range of legal burdens. If pipelines shied away from use of § 311(a), its purpose would be defeated. Section 602(b)(2) could protect against that threat by assuaging the pipelines' concern. A duty not to discriminate, imposed by the Commission on the basis of findings that the duty is necessary to assure consumers access to competitively priced gas, is utterly different. The imposition of the duty here facilitates the accomplishment of Congress's purposes. At least it will do so if the gains in enhanced access offset whatever losses may result from the disincentive effect

on pipelines. The judgment balancing those consequences is for the Commission to make, and it has made it in favor of imposing the duty.[6]

Congress had ample reason to fear that the risk of extraneous legal burdens would chill pipeline interest. Take the laws of Texas. Two years before enactment of the NGPA a Texas court ruled that "[w]hether the business conducted by a pipe line company is actually that of a common carrier is a question of fact," which would depend on the court's perception of whether "the line is available to all producers seeking its service." *China-Nome Gas Co. v. Riddle*, 541 S.W.2d 905, 908 (Tex. Civ. App. 1976). A pipeline's transportation under § 311(a) would expose it to the risk of such "fact" findings, and thus enmesh it in state regulations. In Texas, for example, such classification would subject it to the jurisdiction of the Railroad Commission, *see Op. Atty. Gen.* No. M-175 (1967), to certain health requirements, *see Tex. Civ. Stat. Ann.* § 4477-1(1) & (22) (Vernon 1976 & Supp. 1987), and to such duties and liabilities as a court might find the common law to prescribe, *see id.* §§ 882-884 (Vernon 1964 & Supp. 1987). Most notably, a firm declared a common carrier is required under Texas law to carry, for anyone, any goods of the type for which it is suited. *Id.* § 884.

Pipeline fear of such extraneous burdens might well have rendered § 311 a dead letter. Though we have not identified similar federal hazards, we believe that Congress might well have included the reference to federal law out of anxiety that some overlooked federal provision would operate to thwart § 311's purposes. Viewed in this light, § 602 has nothing to do with a Commission decision to impose a duty of nondiscrimination.

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[6] Thus we reject attacks predicated merely on a view that pipelines will prefer to give up § 311 transportation altogether rather than submit to the conditions that Order No. 436 imposes. *See, e.g.*, Brief of the American Gas Ass'n at 37-41.

The structure of § 602 favors this reading over the broader one urged by the petitioners. Section 602 also provides that no one shall be subject to regulation as a common carrier by reason of providing transportation under 15 U.S.C. §§ 3362(c) or 3363(b), (c), (d), or (i), which involve presidential orders to transport in a natural gas supply emergency. The President's emergency powers are extremely broad, and their exercise could well impose duties quite like those of common carriage, with the President dictating detailed priorities about whom the pipelines should serve. *See id.* § 3363. If the President determined that imposition of something like common carriage were necessary to meet such an emergency, it is hardly credible that § 602 would stand in the way. By the same token, that section must not flatly bar the Commission from imposing similar conditions on gas transportation under § 311.

Congress may conceivably have intended § 602 to bar FERC from conditioning § 311 transportation upon assurances of nondiscrimiantion. We doubt it. But apart from our independent conclusion that it has no such purpose, we regard FERC's interpertation as reasonable. The reasonableness is underscored by FERC's broad duties to assure consumers access to natural gas at prices such as would prevail in the absence of pipeline market power and its conclusion that under the present circumstances fulfillment of that duty requires such conditioning. *Cf. American Trucking Ass'ns, Inc. v. Atchison, T. & S.F. Ry.*, 387 U.S. 397 (1967). We are therefore under *Chevron* bound to uphold the Commission.

A parallel attack on Order No. 436 stresses § 601(a)(2)(A) of the NGPA, 15 U.S.C. § 3431(a)(2)(A) (1982), providing that transportation under § 311 (or under the Presidential emergency powers discussed above) shall not constitute "transportation in interstate commerce" within the meaning of § 1(b) of the NGA. But for this provision, a transporting intrastate pipeline would

fall prey to the Commission's NGA jurisdiction. Several petitioners argue that Order No. 436 imposes burdens substantially identical to those encompassed by NGA jurisdiction. Thus, they argue, application of the open-access condition to intrastate pipelines is an impermissible interference with state regulatory authority. *See* Brief of the American Gas Ass'n at 42-43; Brief of Intrastate Petitioners & Intervenors at 22-29.

Again consideration of the purpose of the provision refutes the attack. Section 602(a)(2)(A) is clearly intended to assure that pipelines' fear of the *automatic* imposition of the burdens of NGA jurisdiction does not make them so chary of § 311 that it languishes unused. This is altogether different from regulatory burdens imposed by the Commission in the exercise of its discretion under § 311(c) in order to make sure that § 311 transportation operates in harmony with the congressional purpose. Thus, even if it were true that the regulatory impact of Order No. 436 were identical to that of NGA jurisdiction, the decision to condition § 311 on acceptance of those burdens would not violate § 601(a)(2)(A).

In fact, of course, the nondiscrimination duties imposed by Order No. 436 by no means encompass all the burdens of NGA jurisdiction. (1) New service under § 311 does not require § 7 certification, and Order No. 436 carries that distinction forward where a pipeline brings itself under the Order: operations under a § 7 blanket transportation certificate entail notice-and-protest procedures more burdensome than the reporting requirements for § 311 transportation. *See infra* part VII.B.* (2) Construction of facilities to be used exclusively for § 311 transportation requires no certification or FERC review at all. *See infra* part VII.D. (3) § 311 transportation does not subject an intrastate pipeline to the detailed accounting provisions applicable to a natural gas company under the NGA. *Compare* 18 C.F.R. part 201. (4) Intrastate pipelines may provide firm *or* interruptible

service without providing both, while interstate pipelines providing one type must also provide the other. *Compare* 18 C.F.R. §§ 284.8(a)(1) & 284.9(a)(1) *with id.* §§ 284.8(a)(2) & 284.9(a)(2).

B. *Alleged Failure to Comply with Mandate of Outer Continental Shelf Lands Act.*

The Petitioner Industrial Groups (the Process Gas Consumers Group and American Iron and Steel Institute) claim that under §§ 5(e) and 5(f) of the Outer Continental Shelf Lands Act, 43 U.S.C. §§ 1334(e) & (f) (1982), the Commission must require every gas pipeline operating in the OCS to provide nondiscriminatory access for others' OCS gas throughout the entire system of the "pipeline entity."

Congress included § 5(e)[7] in OCSLA at the time of original adoption, and then sought to "strengthen[]" it[8] in 1978 by adding § 5(f):

> (f) Competitive Principles Governing Pipeline Operation

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[7] Section 5(e) provides:

> Rights-of-way through the submerged lands of the outer Continental Shelf, whether or not such lands are included in a lease maintained or issued pursuant to this subchapter, may be granted by the Secretary for pipeline purposes for the transportation of oil, natural gas, . . . upon the express condition that oil or gas pipelines shall transport or purchase without discrimination, oil or natural gas produced from submerged lands or outer Continental Shelf lands in the vicinity of the pipelines in such proportionate amounts as the Federal Energy Regulatory Commission, in consultation with the Secretary of Energy, may, after a full hearing with due notice thereof to the interested parties, determine to be reasonable taking into account, among other things, conservation and the prevention of waste.

43 U.S.C. § 1334(e) (1982).

[8] H. Conf. Rep. No. 95-1474, 95th Cong., 2d Sess. 87, *reprinted in* [1978] U.S. Code Cong. & Admin. News 1674, 1686.

> (1) Except as provided in paragraph (2) [the gathering exemption], every permit, license, easement, right-of-way, or other grant of authority for the transportation by pipeline on or across the other Continental Shelf of oil or gas shall require that the pipeline be operated in accordance with the following competitive principles:
>
> (A) The pipeline must provide open and nondiscriminatory access to both owner and nonowner shippers. . . .

43 U.S.C. § 1334(f) (1982).

The language will not bear the proposed load. The statute demands that any permit for *transportation by pipeline* on the OCS require that "the *pipeline*" be operated according to specified principles. The natural reading is that the subject pipeline is the physical facility in the OCS, not every facility owned or operated by the corporation operating that facility. The petitioners call our attention to remarks on the Senate floor reflecting concern about pipeline discrimination. See, for example, Senator Kennedy's observation, "This amendment seeks to insure that OCS pipelines are true common carriers." 123 Cong. Rec. 23,252 (July 15, 1977). But none of the remarks supports petitioners' proposed inference. All are completely consistent with a focus on what Congress had before it—the OCS.[9]

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[9] The same petitioners object to the Commission's allowing a pipeline to offer blanket certificate transportation under § 311 without offering it under § 7 as well. *See* 18 C.F.R. part 284, subparts B and G. This allows a pipeline to provide open access to pipelines and LDCs without offering it *directly* to end users. In the absence of evidence that this decision will seriously impede access for the sort of end user that can buy gas for itself in the wellhead market, we decline to interfere with the Commission's distinction between transportation under the NGPA and transportation under the NGA—a distinction that the pipelines assert has eroded too much.

C. *Claims of Arbitrariness and Caprice.*

1. *Failure to impose the nondiscriminatory access conditions on § 7(c) transportation certificates.*

Maryland People's Counsel finds Order No. 436 defective in that it (potentially) allows a pipeline to provide transportation under an individual certificate issued under § 7(c) without agreeing to provide the same on a nondiscriminatory basis.

We lack jurisdiction over the claim. Section 19(a) of the NGA, 15 U.S.C. § 717r(a) (1982), prohibits any "proceeding to review" an order of the Commission in the absence of an application for rehearing filed within 30 days after issuance of the order, setting forth specifically the ground on which the application is based. The Commission addressed the problem of individual § 7 certificates in Order No. 436, stating in its analysis of comments that it did not intend to apply the nondiscriminatory access provision "on a generic basis to all section 7 certificates at this time." J.A. 388. MPC did not file an application raising the point until March 1986, long after expiration of the 30 days from issuance of Order No. 436 on October 9, 1985.

MPC acknowledges the jurisdictional difficulty, but states that it could not have realized, until February 1986, that the Commission's refusal encompassed certificates for transportation to fuel-switchable customers. At that time, in *Texas Gas Transmission Corp.*, 34 F.E.R.C. ¶ 61,203 (1986), the Commission actually did issue such a certificate without open-access conditions. MPC argues that, in view of the obligations imposed by *MPC II*, and language of the Commission elsewhere in Order No. 436, it was entitled to believe that the Commission's statement referred only "to transport in support of [the pipelines'] merchant function (*e.g.*, where one pipeline transports gas owned by another pipeline) or in ways that would not create the discrimination that the

Commission found unlawful in Order No. 436 (*e.g.*, transportation for high priority customers . . .)." Reply Brief of MPC at 4.

We must reject MPC's reading of Order No. 436's disclaimer. The statement is broadly phrased to encompass "section 7 transportation certificates," and is justified in terms of the Commission's opportunity to scrutinize "individual section 7 transportation arrangements . . . on a case-by-case basis when [the certificates] are applied for." J.A. 388. Both the language and the explanation are fully as applicable to transportation to fuel-switchable users as to any other transportation. MPC of course remains free to challenge the policy by seeking review of individual § 7 orders in which the Commission applies it.

The Commission briefly sought to refute MPC's contention in Order No. 436-D, issued on March 28, 1986. Such discussion was merely dictum, as MPC's March 1986 application was time-barred under § 19 and the Commission so recognized. In any event, the Commission cannot waive the jurisdictional bar of § 19 by selective discussion of belated rehearing applications. *See Boston Gas Co. v. FERC*, 575 F.2d 975, 979-80 (1st Cir. 1978).

2. *Capacity allocation on a "first-come, first-served" basis.*

Several parties attack as arbitrary and capricious the Commission's "first-come, first-served" formula for determining priorities among those who seek transportation service under the Order.

The Commission did not announce this formula in any regulation but merely in material supporting the regulations. *See* J.A. 342, 401-04. It also said that certain claims on pipeline capacity might enjoy favored treatment, "outside the general first-come, first-served rule." J.A. 400. These preferred claims include those of "a firm

sales customer," on the grounds that such a customer "has *already* booked the transportation capacity currently 'bundled' with . . . the sale." *Id.* (emphasis in original). A similar special priority applies to LDCs that exercise the CD conversion option discussed in part IV of this opinion. *Id.* at 401. Further, the "first-come, first-served" concept is evidently not to apply in cases of sudden capacity interruption, but only to the process of "*contracting* for available capacity." *Id.* at 1095-96 (emphasis in original). *But see El Paso Natural Gas Co.*, 35 F.E.R.C. ¶ 61,440, at 62,061 (June 27, 1986).

Apart from introducing the complexity of these exceptions and superior claims, Order No. 436 and its supporting statements contain no guidance about how pipelines are to implement this formula. "First come, first served" is an easy principle to apply in a bakery where each customer pulls a numbered ticket on entering and is served in that order. But in an industry such as natural gas transportation it may often be difficult to say who "comes first."

Here are a few sample questions that the rule fails to resolve: (1) Suppose that *A*, an end user, contracts with a pipeline for the right to transmit up to five billion Btu per day for five years. At the end of four years *A* seeks to renew the contract on the same terms. But others have earlier filed requests that in the aggregate exceed the pipeline's capacity. Does *A* go to the end of the line? Such a result would probably disrupt most notions of ordinary business arrangements in this market. But if *A* and persons similarly situated enjoy a sort of super-priority, open access will be an empty promise for new would-be users. (The Commission appears to lay great stress on the date on which a request is filed, J.A. 1191, but the full implications are nowhere spelled out.) (2) What of efforts by *A* to secure not merely continued but additional transportation at the end of a fixed-term contract? Would *A* go to the end of the line for the

increment? (*See El Paso Natural Gas Co., supra*, at 62,060.) (3) What is the impact of a minor change in point of receipt? If such a change forces the user to go to the end of the line, then an LDC or end user may find it hard to shift from one supplier to another. *See* Brief of Baltimore Gas & Elec. Co. at 17. (4) May a pipeline charge a fee for accepting requests for service? If not, how can it prevent all potential users from filing immediately for virtually unlimited claims on capacity for an indefinite period of time?

The most potent objection to the Commission's treatment of the problem—and one that is unquestionably ripe—is the contention that it leaves an intolerable gap in the regulatory structure. That gap creates some risk that pipelines may use the resulting leeway to persist in the discrimination that Order No. 436 nominally forbids. It leaves even the most willing pipeline uncertain as to what full compliance requires. On the other side, shippers cannot know what steps they must take to secure adequate priority status or what should guide them in choosing between bundled and unbundled service.

The Commission's brief treats the problem dismissively, noting that aggregate annual gas consumption has fallen from a peak of 22.6 trillion cubic feet in 1973 to only about 17-18 Tcf currently. FERC Brief at 101. This comment seems utterly irrelevant: the problem is surely capacity at *peak* periods. The Commission expressly concedes that generally pipelines have operated at capacity during the winter peak. *See* FERC Brief at 103 n.3; J.A. 280.

Nonetheless, as each pipeline elects to become an open-access transporter, it must file tariffs with the Commission to govern the service, which tariffs must include any "operational conditions" the pipeline proposes to apply. 18 C.F.R. §§ 284.7(a), 284.8(c), 284.9(c). *See, e.g., El Paso Natural Gas Co.*, 35 F.E.R.C. ¶ 61,440 (June 27, 1986). These filings afford the Commission an opportu-

nity to develop standards of permissible capacity allocation. Accordingly, the essential legal issue is the validity of the Commission's choice to address the problem in that format rather than in the format of generic rulemaking.

It is clear that this choice "lies primarily in the informed discretion of the administrative agency." *SEC v. Chenery Corp.*, 332 U.S. 194, 203 (1947). The Supreme Court has noted that such resolution is appropriate where problems arise that the agency could not reasonably foresee, or where its experience makes adoption of a "hard-and-fast" rule unsuitable, or where the problem is so specialized and variable as to be "impossible of capture within the boundaries of a general rule." *Id.* at 202-03. *See also NLRB v. Bell Aerospace*, 416 U.S. 267, 294 (1974). While the Commission has said little or nothing to explain why it is sensible to postpone these decisions to the stage of review of individual proposals, the necessity of its conducting that review seems to us, at this point, an adequate ground for deferring to its judgment.

This is not to say, however, that the Commission may endlessly postpone the necessary decisions. Failure to make the rule reasonably determinate by the time a pipeline starts Order No. 436 operations would severely constrain the Commission's authority to enforce the Order against the pipeline. Such failure would at least complicate actions seeking injunctive relief against pipelines under § 20 of the NGA, 15 U.S.C. § 717s (1982), and would probably make impossible any effort to secure penalties under § 21, 15 U.S.C. § 717t (1982). *See NLRB v. Majestic Weaving Co.*, 355 F.2d 854, 860 (2d Cir. 1966) (Friendly, J.) ("the [judicial] hackles bristle still more when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known, or might even have been taken in express reliance on the standard previously established"). *Cf. Boyce Motor Lines, Inc. v. United States*, 342 U.S. 337, 340 (1952) (requirement of adequate

notice for criminal enforcement of administrative regulations). Moreover, if the Commission approves plans of compliance so vague that enforcement is impaired, its posture will be essentially that found fatally defective in *MPC II*: it will have authorized blanket certificate transportation under rules not adequately grappling with the potentially discriminatory effects.

The Commission's oracular procrastination (a blend of Delphi and Fabius) makes challenges to the specifics of "first come, first served" unripe. These challenges include assertions that the policy (1) gives inadequate attention to contractual commitments or to "dependency" as bases of distinction; (2) unduly threatens the security of supply of LDCs; and (3) disregards equities based on prior payments for pipeline capacity. *See, e.g.*, Brief of Interstate Pipeline Group at 35-36; Brief of Associated Gas Distributors at 39-41. One intervenor also poses a carefully reasoned attack on the Commission for its failure to consider alternatives such as an auction system. *See* Brief of Baltimore Gas & Elec. Co. at 19-20. Though the point is much closer, the Commission's vagueness and lack of commitment are such that even this attack appears unripe. The ripeness doctrine seeks to

> prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.

Abbott Laboratories v. Gardner, 387 U.S. 136, 148-49 (1967). As the Commission confined its disposition of the issue to some general remarks in its supporting statement, our involvement in the merits at this stage would defy these principles.

III. Rate Conditions

With the stated intention of imposing on pipelines more of the risk and responsibility for their own business decisions, the Commission has established a system of flexible rates. *See* 18 C.F.R. §§ 284.7, 284.8(d), 284.9(d).[10] Tariffs are to provide for ceilings and floors, with the pipeline free to charge anywhere within that band. Each maximum rate is to be based on what is typically known as "fully allocated cost," *i.e.*, a rate such that, if the pipeline carries projected volume at the specified unit price, it should exactly recover all costs allocable to the relevant service for the period. *See* 18 C.F.R. § 284.7(c)(3). Minimum rates are to be based on average variable cost. *See* 18 C.F.R. § 284.7(d)(4)(ii). The maximum rates are to vary depending on whether the service is in a peak or off-peak period, and on whether it is firm or interruptible service. A pipeline discounting any service from the maximum rate must, within 15 days of the close of the billing period, report the maximum rate for the transaction, the rate actually charged, the shipper's identity, and any corporate affiliation between pipeline and shipper. 18 C.F.R. § 284.7(d)(5)(iv).

Pipelines may charge a "reservation fee" for firm service. Otherwise shippers could request whatever volume they liked, without cost and regardless of intent to use. As requests would vastly exceed capacity, the pipeline could not rationally plan capacity allocation. *See* J.A. 457-60. Apart from the reservation fee, pipelines are required to charge on a "volumetric" basis, *i.e.*, a

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[10] These sections govern permissible rates for transportation by interstate pipelines under § 7 blanket certificates and under § 311. Rates charged by intrastate pipelines under § 311 are required to be "fair and equitable." *See* NGPA § 311(b)(2)(A), 15 U.S.C. § 3371(b)(2)(A) (1982); 18 C.F.R. §§ 271.101-.1106 (1985). Order No. 436 also requires intrastate pipelines to adhere to the restrictions on reservation fees that Order No. 436 imposes on interstate pipelines' transportation. *See* 18 C.F.R. § 284.123(b).

simple charge per unit actually transported, without a "demand charge" or "minimum bill."

A. *Absence of Finding that Prior Rates Were Unlawful.*

The Interstate Pipeline Group objects that the Commission did not make specific findings that any rates charged by individual pipelines were unlawful before imposing the new rate conditions. The Commission is not required to make individual findings, however, if it exercises its § 5 authority by means of a generic rule. *See, e.g., Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1165-68 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986). The pipelines seek to distinguish *Wisconsin Gas* on the ground that it "involved specific findings as to a single billing term," to wit, minimum bill provisions that included variable costs. (Minimum bills charge for specific portions of contract demand even as to gas that is not taken; the Commission believed that inclusion of variable costs in such bills imposed an unjustifiable restriction on customer choice of gas supply and improperly sheltered pipelines from competition.) The distinction is irrelevant. What justified the generic approach in *Wisconsin Gas* was the Commission's conclusion that *any* tariff violating the rule would have such adverse effects on the interstate gas market as to render it "unjust and unreasonable" within the meaning of § 5. That is precisely what the Commission has concluded here.

The pipelines may be claiming that the Commission's failure to adduce evidence meeting the standards of adjudication breaches the substantial evidence requirement of § 19 of the NGA, 15 U.S.C. § 717r (1982). Again *Wisconsin Gas* is dispositive. There the court reaffirmed the court's conclusion in *American Public Gas Ass'n v. FPC*, 567 F.2d 1016 (D.C. Cir. 1977), that § 19's reference to "substantial evidence" located as it is in the provision guiding judicial review, does not dictate the procedure to be employed in FERC's notice-and-comment rulemakings. *Wisconsin Gas*, 770 F.2d at 1167-68.

Finally, the pipelines' complaint may be that the Commission adopted its new rate criteria without "factual" submissions tracing a relationship between rate practices formerly permitted and the evils that it sought to correct. There may be circumstances in which such a claim would prevail. In *Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511, 1514 (D.C. Cir. 1984), for example, this court declared that "mere reliance on an economic theory cannot substitute for substantial record evidence and the articulation of a rational basis for an agency's decision." In fact, however, the court in *Electricity Consumers* was persuaded that the Commission had "inexplicably distorted" the theory that it claimed to apply. *Id.* Here the pipelines point to no such inexplicable distortion.

Promulgation of generic rate criteria clearly involves the determination of policy goals or objectives, and the selection of means to achieve them. Courts reviewing an agency's selection of means are not entitled to insist on empirical data for every proposition on which the selection depends. *Wisconsin Gas* made that clear. For example, in the rulemaking proceeding parties had objected that curtailment of the minimum bill would result in the pipelines shifting costs to its most captive customers. The Commission responded in part with a prediction that "the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers." 770 F.2d at 1161. The court accepted this without record evidence, presumably because it viewed the prediction as at least likely enough to be within the Commission's authority. Clearly nothing in *Electricity Consumer's* reference to "economic theory" was intended to invalidate agency reliance on generic factual predictions merely because they are typically studied in the field called economics. Agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that competition will normally lead to lower prices.

In support of this objection the pipelines do not identify any factual proposition, relied on by the Commission, that they regard as requiring additional support. Accordingly, the objection cannot succeed.

B. *Allowance of Discounting Generally.*

Several petitioners object that the Commission's allowing pipelines to discount from the maximum rates is in effect an approval of "undue preference[s]" and "undue discrimination" in violation of §§ 4 and 5 of the NGA. But "the mere fact of a rate disparity" is not enough to constitute unlawful discrimination. *Cities of Bethany v. FERC*, 727 F.2d 1131, 1139 (D.C. Cir.), *cert. denied*, 469 U.S. 917 (1984). The reporting system will enable the Commission to monitor behavior and to act promptly when it or another party detects behavior arguably falling under the bans of §§ 4 and 5. This provision for flexibility conforms to Congress's intention in the NGA to allow a vital role for private contracting between the parties. *See United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 338-39 (1956); *see also Sea-Land Service, Inc. v. ICC*, 738 F.2d 1311, 1316-19 (D.C. Cir. 1984) (rejecting proposition that "contract rates," based on individual contract but available to similarly situated shippers of like commodities, are automatically violative of nondiscrimination principle). Accordingly, given the Commission's broad latitude to choose between rulemaking and adjudication, *see SEC v. Chenery Corp.*, 332 U.S. 194 (1947),[11] we could find the provisions illegal only if they carried such a risk of allowing undue discrimination or preferences as to be arbitrary and capricious. We do not find the risk so high.

The Associated Gas Distributors call our attention to the problem of discounts in favor of a pipeline's gas

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[11] *See also supra* part II.B.3.

trading affiliate. We recognize that such transactions may carry more than the usual risk of undue discrimination. *Cf.* NGPA § 601(b)(1)(E), 15 U.S.C. § 3431(b)(1)(E) (1982) (imposing a special limit on pipeline recovery of cost of gas purchased from affiliate). But we see no reason to think that such a discount should be *per se* unduly discriminatory. If a pipeline gives its gas trading affiliate discounts identical to those given to unaffiliated parties in identical circumstances, the discount would not be unlawful merely on account of the affiliation. Accordingly, the risk of such discounts proving invalid is insufficient to justify invalidation of the rule.

C. *Potential Discrimination Between Bundled and Unbundled Transportation.*

Other petitioners suggest that the Commission's rate regulations are invalid because they sanction undue discrimination between unbundled transportation and the transportation component of a bundled sales transaction. That the criteria governing permissible rates in the two categories are different, however, does not establish discrimination between them. Most notably, the petitioners point to no reason to suppose that, as a whole, unbundled transportation service will recover a lower proportion of its costs than will the transportation component of unbundled sales. Indeed, the rate provisions specify that the maximum rates for each subcategory of unbundled transportation are to be designed to recover "solely those costs which are properly allocated to the service to which the rate applies." 18 C.F.R. § 284.7(d)(4)(i). That the pipelines may offer discounts does not alter the case. They do so at their own risk, *see especially id.* at § 284.7(a)(5)(iii) (disallowing any rate seeking to recover losses from a prior period); pipeline managements will presumably aim at a pricing strategy that will, in fact, fully recover costs allocable to unbundled transportation. We cannot evaluate the rule on the basis of an assumption that they will not succeed. (We address below a claim

that the rate provisions disable pipelines from full recovery of unbundled transportation costs.)

The claim of discrimination in favor of unbundled transportation contains a more subtle argument (or at least the seeds of such an argument): even though such rates may recover exactly the cost of service (just as for the transportation component of sales service), perhaps the flexibility afforded pipelines will in effect give unbundled transportation an advantage over sales service. The possibility is hardly one that we may rule out *a priori*. But we think it a problem that the Commission should be free to solve if and when it develops. As the Commission points out, the historical problem has been that unbundled transportation rate provisions put it at a *disadvantage* as against sales service. J.A. 318. No one appears to dispute that finding. It seems wholly suitable for the Commission to experiment with one rate structure in this specialized area; if it proves a triumphant success, the Commission will doubtless have opportunities to extend it to sales.

D. *Selective as Opposed to Uniform Discounts.*

Some parties accept the concept of price discounting but argue that the Commission should allow only "uniform" discounting (in effect requiring a pipeline to promulgate in advance the criteria under which it would provide discounts). The Commission, however, made the judgment that such a rule would unduly stifle discounting. J.A. 478-83. It saw substantial gains from such discounts: cheaper fuel supplies for the price-elastic customers receiving the discounts; reduced revenue shortfalls for pipelines that would otherwise lose the business altogether; and protection for non-favored customers from rate increases that would ultimately occur if pipelines lost volume through inability to respond to competition. J.A. 483.

For much the same reasons that courts allow administrative agencies the leeway to choose between rulemaking and adjudication (variability of circumstances, difficulties of foresight), we think that the Commission was within its power to allow pipelines a parallel choice. But, just as courts insist on a degree of agency consistency, *see, e.g., Local 32, American Federation of Gov't Employees v. FLRA*, 774 F.2d 498, 502 (D.C. Cir. 1985), we expect that the Commission will exact from the pipelines as much consistency of application as is necessary for both to be in conformity with §§ 4 and 5.

E. *Consistency of "Value-of-Service" Discounting with MPC II.*

The American Public Gas Association and others contend that the general consent to selective discounting violates this court's decision in *Maryland People's Counsel v. FERC* (*"MPC II"*), 761 F.2d 780 (D.C. Cir. 1985). The attack is directed especially to Commission suggestions—in supporting statements, not the rule itself—that discounting intended to meet competition from alternative fuels or indeed from other pipelines is not *per se* unduly discriminatory. J.A. 476.

Petitioners misconceive the scope of *MPC II*. Pipelines were using their market power in the transportation market to discriminate (indirectly) in the sale of gas, a commodity that Congress had concluded was produced under roughly competitive conditions. In the sale of such a commodity there is no economic justification for charging different prices based on the purchasers' differing access to substitutes (*i.e.*, their price elasticity of demand). Indeed, if a product is produced under competitive conditions, such price discrimination cannot occur unless a bottleneck with market power stands between it and the customers. By contrast, pipeline transportation service is marked by a degree of natural monopoly, J.A. 305-06, 352, 481 (*i.e.*, longrun average costs decline in the

relevant range of production). *See* 2 A. Kahn, *The Economics of Regulation: Principles and Institutions* 119-23 (1971). In such an industry, "value-of-service" ratemaking (*i.e.*, rates varying on the basis of differing demand characteristics) has an established place,[12] though not an uncontested one.[13] The equitable argument in favor of such differentials is that they may benefit captive customers by making a contribution to fixed costs that otherwise would not be made at all. (The efficiency argument is that such differentials will raise total volume closer to the level it would attain if all sales were priced at marginal cost.)

These justifications were missing in *MPC II*. There the court found that the then-existing blanket certificate regulations allowed pipelines to deny captive consumers access to the spot market for gas while providing it for the non-captives. 761 F.2d at 788. This allowed pipelines to preserve the revenues attributable to transportation of gas to fuel-switchable customers, while continuing to sell their inventory of overpriced gas to captive customers. The Commission advanced an argument that the pipelines'

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[12] *See* E. Gellhorn & R. Pierce, *Regulated Industries* 185-89 (1987).

[13] *See* Tye & Leonard, *On the Problems of Applying Ramsey Pricing to the Railroad Industry with Uncertain Demand Elasticities*, 17A Transportation Research 439 (1983); Tye, *Ramsey Pricing and Market Dominance Under the Staggers Rail Act of 1980*, 24 Transportation Research Forum 667 (1983); Meyer & Tye, Toward Achieving Workable Competition in Industries Undergoing a Transition to Deregulation (March 19, 1987) (unpublished). We do not understand these critics to attack rate differentials where application of some apparently egalitarian principle, such as an equal revenue-to-variable-cost ratio, would result in prices for some customers or commodities above what the profit-maximizing monopolist would charge. *See* Tye, *Ramsey Pricing and Market Dominance Under the Staggers Rail Act of 1980*, 24 Transportation Research Forum at 669-70; Henderson, *Price Discrimination Limits in Relation to the Death Spiral*, 7 Energy Journal (No. 3) 33, 37 (1986).

receipt of transportation revenues would redound to the benefit of captive customers—an argument that sounds like the one advanced above. The court said no. First, we said that the Commission had offered no reason to think that the captives could not enjoy the fuel switchables' contribution to fixed costs even if the Commission conditioned the program on equal access for captive consumers—precisely what the Commission has done here. *Id.* Second, we pointed out that the Commission had nowhere answered the petitioners' argument that the captives' loss through lack of access to the wellhead market would greatly exceed their gain through the fuel-switchables' contribution to fixed costs. *Id.* Here, of course, the Commission is providing access to the spot market. Thus the facts here obviate our two reasons for rejecting the Commission's argument on contributions to fixed costs.

To read *MPC II* as a rule that price differentials based on demand conditions are always unduly discriminatory would render the decision a defiant and unreasoned exception to the general pattern. The judicial acceptance of such price differentials is longstanding. For nearly 100 years, for example, the courts have interpreted the anti-discrimination provisions of the Interstate Commerce Act to allow the ICC to approve differentials justified exclusively by competition. *See, e.g., Texas & Pacific Ry. v. ICC*, 162 U.S. 197, 218-19 (1896); *Dresser Industries, Inc. v. ICC*, 714 F.2d 588 (5th Cir. 1983) (review under three different anti-discrimination provisions); *National Gypsum Co. v. United States*, 353 F. Supp. 941, 946-49 (W.D.N.Y. 1973) (enumerating cases following this view). Indeed, the Supreme Court has even struck down an ICC finding of unlawful discrimination where it appeared to be based on an absolute rule that competitive conditions could never justify a rate differential. *Eastern-Central Motor Carriers Ass'n v. United States*, 321 U.S. 194 (1944).

We have answered the claims that the rate provisions of Order No. 436 put it in violation of our mandate in *MPC II*. This is not to say, of course, that the Commission is free to uphold every price distinction based on different demand elasticities. It has long been contended, for example, that rate differentials based exclusively on competition between transporters with similar cost functions may end up forcing captive customers to bear disproportionate shares of fixed costs without any offsetting gain in efficiency. *See, e.g.*, 1 A. Kahn, *The Economics of Regulation: Principles and Institutions* 159-81, esp. 170 (1970). The contention is not self-evidently true: if the demand of buyers with access to competing carriers is at all price elastic, the price reductions they enjoy will raise their demand close to competitive levels. In any event, the Commission may properly defer its ultimate resolution of these issues to another day and another proceeding. *Cf. American Commercial Lines, Inc. v. Louisville & Nashville R.R.*, 392 U.S. 571 (1968) (finding broad discretion in ICC to choose format in which to resolve issues of price discounting in competition between railroads and barge-truck combinations).

F. *Impact of Discounting on Pipeline Solvency.*

Petitioners ANR Pipeline Company and Colorado Interstate Gas Company fault the regulations for allowing the pipeline to discount below the ceilings but never to charge more. To the Commission's defense that the discounting mirrors the world of unregulated firms, they respond that in such a world the circumstances where market conditions force a firm to discount are likely to be matched by ones allowing the charge of a premium. (In equilibrium firms will earn a normal profit.) Here, they argue, the rules parallel only the downside of the unregulated market. As a result, they say, return will necessarily be less than in other industries with corresponding risks, in violation of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

We can imagine a rate methodology under which this contention would be sound. Suppose that a pipeline has a capacity for transporting 120,000 units a year, that each year's share of fixed costs amounts to $90,000, and that variable costs are $.10 per unit. In an initial rate case, the Commission projects volume at 100,000 units, and thus sets a maximum price of $1.00 per unit ($.90 as a share of fixed costs and $.10 for variable costs).

While those rates are in effect, suppose the firm in fact carries 100,000 units at $1.00, but, spotting market opportunities, carries another 10,000 units at $.20 per unit for customers who would switch to alternative fuels if the transportation charge rose above $.25 per unit. (If the pipeline knew that $.25 was the switchover point, it would charge that, but it may not know exactly.)

In the next rate case, suppose the Commission projects use at 110,000 units, and accordingly sets the maximum price at $.92 per unit ($.10 for variable costs and $.82 ($90,000/110,000) for fixed costs). Such a rate would be sufficient to recover costs only if the pipeline carried 110,000 at the maximum rate; but the evidence overwhelmingly suggests that it will not be able to do so—the extra 10,000 units of business were due to the discount. Unless some change in circumstances saves the pipeline, revenue will be $94,000 ($92,000 for 100,000 units transported at the maximum rate plus $2,000 for 10,000 units at $.20), against costs of $101,000 ($90,000 fixed and $11,0000 variable).

We see no reason, however, to suppose that the Commission intends such calculations. Its only statement relating to projections, 18 C.F.R. § 284.7(c)(3), indicates the contrary:

> The pipeline's revenue requirement allocated to firm and interruptible services should be attained by providing the projected units of service in peak and off-peak periods at the maximum rate for each service.

In its commentary, the Commission pointed to this passage as proof of its agreement with MPC's suggestion that "revenue projections in rate filings [should] assume that all sales and transportation volumes will be charged at the maximum rate." J.A. 484. Thus, it appears that "rate" in § 284.7(c)(3) refers to the maximum unit price, not to projected throughput. This would appear to undermine any fear that the Commission might employ the dubious procedure hypothesized above.

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Thus we find no legal defect in the rate provisions of Order No. 436.

IV. CONTRACT DEMAND ("CD") ADJUSTMENT

Local distribution companies require a firm supply of gas. Typically they have looked to pipeline sales service to fill this need. Firm sales contracts give the customer the right to demand, and obligate the pipeline at all times to stand ready to deliver, a certain quantity of gas per day, generally known in the industry as "Contract Demand" or "CD." Once the arrangement receives the necessary certificate under § 7 of the NGA, the LDC's entitlement and the pipeline's obligation acquire a legal existence independent of the contract and persist until the Commission issues formal approval of "abandonment." *See California v. Southland Royalty Co.*, 436 U.S. 519 (1978); *Panhandle Eastern Pipe Line Co. v. Michigan Consolidated Gas Co.*, 177 F.2d 942, 945 (6th Cir. 1949). For a "full requirements" customer, relying on a single pipeline, the CD will amount to its entire anticipated gas needs; "partial requirements" customers, as the name suggests, rely on more than one pipeline.

"Demand charges" are based on CD and are payable regardless of the customer's actual use; having thus committed itself to partial payment for the gas covered by its CD, a customer pays only a "commodity charge" when

it actually takes gas.[14] Thus, if the demand charge is $1 and the commodity charge $3, the customer will switch to an alternative supply only when the alternative's total cost (transportation and gas) is under $3, even though (in a sense) gas at $3.50 would be a better bargain. (It is better only "in a sense" because the customer gets a security of supply from its pipeline supplier that it does not get in the spot market.) The relation with a regular pipeline supplier thereby constrains the customer's practical freedom to take advantage of open access to the wellhead market. The higher the CD in relation to its total usage, and the higher the demand charge as a proportion of total price, the more severe is the constraint.

To make the customers' access meaningful, Order No. 436 provides customers a limited right to unilaterally modify their contracts with pipelines who elect to operate under the Order. It entitles any party with a firm sales contract on the date the pipeline becomes subject to Order No. 436[15] to (a) convert specified percentages of its CD from gas purchase (*i.e.*, fully bundled service) to unbundled gas transportation or (b) reduce its CD by the same percentages.

The entitlement to convert or reduce[16] is 15% for each of the first and second years, 20% for the third year, and

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[14] Order No. 436 largely retains this two-tiered rate structure, with firm transportation customers paying a "reservation" fee for the guaranteed right to call on a certain amount of the pipeline's capacity and a "volumetric" fee to cover the variable cost of providing the service actually called for. *See supra* part III.

[15] A pipeline becomes subject to the provisions of Order No. 436 for these purposes when it accepts a blanket certificate, provides service under the § 311 regulations after a certain date, or commences or continues transportation of OCS gas under a blanket certificate. 18 C.F.R. § 284.10.

[16] A customer may elect both to convert and to reduce, but the total adjustment to CD cannot exceed the customer's accrued entitlement. 18 C.F.R. § 284.10(e).

25% for each of the fourth and fifth years. The entitlements are cumulative. For example, a firm customer could reduce contract demand not at all in the first two years and then reduce by 50% in the third year. Or it could refrain from exercising the option at all in the first four years, and then reduce by 100% in the fifth year or any year thereafter. *See* Order 436-C, J.A. 1355-60.

Petitioners attack the Commission's CD adjustment program on several fronts. A number of pipelines assert that the conditions violate the rule of *Panhandle Eastern Pipe Line Co. v. FERC*, 613 F.2d 1120 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 889 (1980), restricting the use of the Commission's power to impose conditions on certificates issued under § 7. In addition, the pipelines attack the sufficiency of the Commission's reasoning for adopting CD conversion and CD reduction. With respect to CD reduction a number of LDCs lend their voices to the attack. Finally, Maryland People's Counsel contends that this court's opinion in *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (*"MPC III"*), compels the Commission to permit customers to convert 100% of their CD to transportation immediately.

A. *Legal Authority.*

1. *Violation of Panhandle doctrine.*

Several pipelines contend that the Commission's creation of the CD conversion/reduction options violates the principle established by this court in *Panhandle, supra.* Panhandle had applied for certification under § 7(c) of new transportation service to an industrial gas user. Exercising its § 7(e) authority to attach "such reasonable terms and conditions as the public convenience and necessity may require," the Commission approved the certification subject to a condition requiring Panhandle to "flow" the resulting revenues through to its wholesale gas customers. The condition effectively gave the latter a rate reduction equal to the new revenues. The Commission's

theory was that the wholesale gas customers had already paid for the capacity used to provide the service to the industrial user (or had obligated themselves to do so under existing rates). 613 F.2d at 1123. This court held, however, that such a use of the Commission's § 7 conditioning authority was an illegal circumvention of § 5. The latter authorizes the Commission to modify pipeline rates and charges when it finds them "unjust, unreasonable, unduly discriminatory, or preferential," but only after notice and hearing in which, it is well established, the Commission bears the burden of proof. *See, e.g., Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 184 (D.C. Cir. 1986).

In the present case, the Commission's creation of the CD conversion/reduction option similarly modifies previously approved arrangements that are separate from the transportation authority that a pipeline would seek under Order No. 436. On its face, it appears to challenge *Panhandle*'s strictures against extensions of the § 7(e) conditioning power that would erode substantive or procedural limits on the Comission's power.

The Commission has taken high ground, which we think quite untenable. It argues that since application for a blanket certificate under § 7 is entirely voluntary, there is no need for it to point to any express congressional grant of power. It asserts that in the CD modification conditions it was "*not requiring* the adjustment of previously-certificated service. . . ." FERC Brief at 107 n.1 (emphasis added). Obviously the suggestion that *Panhandle* presents no problem because the application for certification is voluntary is unacceptable. As all § 7 applications are voluntary in a legal sense, the Commission's theory would extirpate the *Panhandle* doctrine.

Apart from the voluntariness theory, the Commission notes that it has invoked § 7(b), authorizing it to permit natural gas companies to abandon certificated service. In 18 C.F.R. § 284.10(f)(3) it expressly finds that pipe-

line abandonments of service, pursuant to customer elections under the Order, are "permitted by the present or future public convenience and necessity." But this finding looks only to the pipeline's obligation, as is fitting under § 7(b). Neither that section nor the finding thereunder supports the Commission's relieving customers of their contract obligations.

For that, it appears one must turn to § 5 of the NGA, which allows the Commission to set aside any unjust, unreasonably or unduly discriminatory "contract affecting" rates and charges. Much of the Commission's reasoning suggests a belief that under present circumstances inflexible CDs in fact qualify as "unjust, unreasonable, [or] unduly discriminatory" terms. But the Commission has expressly declined to rely on § 5, and has not explained why not. J.A. 1059.

The "voluntariness" theory and the invocation of § 7 (b) appearing inadequate, and the Commission having disclaimed reliance on any other provision (notably § 5), the CD modifications are without basis in law insofar as they condition blanket certificate transportation under the NGA on release of customers from contract obligations. (Immediately below we address the issue of transportation under § 311.) On remand, the Commission can proceed under such grants of power as it believes are relevant undistracted by the notion that its power under § 7(e) entitles it to sweep aside the substantive and procedural constraints of the NGA. In so doing, of course it may employ rulemaking. *Cf. Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986).

CP National and other LDCs contend that the Commission is without authority to impose the CD conversion/reduction option as a condition of authority to transport under § 311 of the NGPA. No analysis is offered in support of the claim. The premises of the *Panhandle* doctrine are absent here. Perhaps because of its expectation

that § 311 would operate simply to forge interstitial links between the hitherto separate interstate and intrastate markets, *see Public Service Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342 (1983); *Process Gas Consumers Group v. United States Dep't of Agric.*, 694 F.2d 728, 764 (D.C. Cir. 1981) (other portions vacated and reconsidered *en banc*, 694 F.2d 778 (D.C. Cir. 1982)), *cert. denied*, 461 U.S. 905 (1983), Congress never created for § 311 transportation any elaborate structure paralleling that of the NGA. This claim fails.

In summary, the Commission has failed to ground the CD adjustment provisions in any adequate section of the NGA. Because the conditions can legally apply to § 311 transportation, however, and because we have no reason to expect that the Commission's interest in attaching the options to § 7 transportation has waned, we proceed to address a number of other attacks.

2. *Alleged lack of compliance with § 7(b).*

As noted above, the Commission has, in the CD modification provisions, identified circumstances under which pipelines are automatically entitled to abandonment of service—namely, when the customer exercises the election provided. In support of this it has made the necessary finding under § 7(b) that such abandonment serves the "public convenience or necessity." [17] CP National and others fault the Commission for failing to make various specific findings said to be subsidiary parts of that conclusion. They cite, for example, *Transcontinental Gas Pipe Line Corp. v. FPC*, 488 F.2d 1325, 1329-30 (D.C. Cir.

[17] We see no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment (*i.e.*, establish a system of "pre-granted" abandonment approval). *Cf. Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986) (approving modification of tariffs in a generic § 5 proceeding).

1973), *cert. denied*, 417 U.S. 921 (1974), overturning the Commission's decision to permit certain producers to abandon sales to an interstate pipeline. In that context, the court held that the Commission must study various factors and make a "broadly conceived comparison of the needs of the two natural gas systems [the current purchaser and the producers' intended substitute] and the public markets they serve." *Id.* at 1330 (footnote omitted).

The petitioners implicitly assert that the substantive ingredients of the "public convenience or necessity" are the same regardless of the type of abandonment. This makes no sense. Clearly the substantive concerns relevant to terminations at the option of LDCs are altogether different from those relating to producers' abandonment of their sales to pipelines in a period of acute shortage, as was the case in *Transcontinental.*

Elizabethtown Gas Company derives from *Transcontinental* the proposition that the Commission cannot wholly defer to private parties' choice. *Id.* at 1328-29. We see no conflict between that precept and the Commission's action here: nothing in *Transcontinental* prevents the Commission from identifying circumstances which, when coupled with the purchaser's election, satisfy the public convenience and necessity.

B. *Adequacy of the Commission's Reasoning in Support of CD Conversion.*

Pipelines attack CD conversion as arbitrary and capricious, focusing mainly on its impact on preexisting supply arrangements. They entered into these arrangements primarily in response to their Commission-imposed obligations to maintain sources of supply adequate to meet their sales commitments,[18] *see* 18 C.F.R. § 2.61, and

[18] In some cases these commitments were not freely entered into, but are the product of Commission orders under NGA § 7(a) that the pipeline extend service to a particular customer.

in reliance on their ability to recoup the costs through firm sales contracts. The arrangements consist largely of long-term supply contracts with producers, but also include investments in expensive facilities for the importation of liquefied natural gas ("LNG"), *see Trunkline LNG Co. (Opinion No. 796)*, 58 F.P.C. 726 (1977); *Trunkline LNG Co. (Opinion No. 796-A)*, 58 F.P.C. 2935 1977).[19] In addition to arguing that the rule defeats their justifiable reliance on their sales contracts, the pipelines argue that the Order is shortsighted: seeing their treatment in this situation, pipelines will hardly jump to meet any future shortage or come to the assistance of a converting LDC that later finds itself in trouble when the market tightens.

An assertion that agency conduct was arbitrary and capricious requires the court to explore the links between that conduct and the agency's statutory authority. We must examine the agency's reasoning to determine whether its considered the relevant factors and drew "a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168 (1962)). Here we are hampered because, insofar as the Commission has attached the CD conditions to § 7 blanket certificate transportation, its asserted statutory basis, § 7(e), is legally insufficient. *See supra* part IV.A.1. However, in attaching the condition to § 311

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[19] Panhandle and Trunkline seek to supplement the reliance argument by noting that the investments were made on the assumption that "rolled-in" pricing (*i.e.*, charges by pipelines based on average gas cost rather than marginal cost) would enable the pipelines to recover the costs. The Commission approved the investments, and in doing so acknowledged that average pricing was essential to cost recovery: no customer would buy the LNG at its full price. *Opinion No. 796-A*, 58 F.P.C. at 2940. The point does not enhance their claim; rolled-in pricing remains. The pipelines' problem is that even when prices are rolled in, their embedded contract costs for gas exceed what the current market will bear.

transportation, the Commission plainly invokes the authority of § 311(c), which allows it to prescribe "terms and conditions." Section 311 itself states no explicit standards for the exercise of the power, but the overall purposes of the NGPA provide a standard—somewhat amorphous to be sure—against which we can and must measure the Commission's decision. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 776 (1968). Given the overlap in the purposes of the NGA and the NGPA this process will have implications for possible future exercises of the Commission's NGA authority, presumably § 5, but in view of the Commission's disclaimer of reliance on § 5, our analysis does not directly apply to such an exercise.

Unilateral abrogation of a contract is an extreme measure. This is true even where the abrogation is partial, as it is under the conversion option, and even though common law doctrines of impracticability and impossibility shift the risk allocation nominally arrived at by the parties. (They may well do so only to arrive at the allocation the parties would have made had they considered in advance the risk that eventuated. Posner & Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. Legal. Stud. 83 (1977).) Nonetheless, we find the reasoning underlying CD conversion persuasive.

Unlike the typical contract, those at issue here necessarily reflect the pipelines' monopoly power. The Commission found the transportation network "highly monopolistic in some markets, fairly competitive in others." J.A. 281. Historically, in fact, many customers have been served by only one pipeline. J.A. 279. This is not disputed. Until the recent partial unbundling of pipeline sales and transportation service, the pipelines were the only parties from whom LDCs might practicably buy gas. Once the unbundling of services began, the LDCs' position changed little, as the pipelines wielded their monopoly

power over transportation to deny them the ability to purchase from would-be competing suppliers. J.A. 318, 352 (finding practice "unduly discriminatory and preferential"). Absent these market restraints, there is no reason to believe that the LDCs would have agreed to the long-term sales contracts binding them to pay rates based on the pipelines' costs, whatever those might be.[20] Yet, by virtue of these arrangements, the LDCs found themselves denied access to the spot market, which offers prices at least 20% below the pipelines' average gas costs.[21] *See supra* part I.

FERC thus found that to remedy these effects, it was essential to permit limited LDC abrogation of pipeline sales contracts:

> The transitional contract demand reduction and conversion options are essential if the goal of nondiscriminatory access to transportation is to be achieved . . . . With such an option, full-requirements customers—especially small, sole-supplied local distribution companies . . .—will have access to competitively-priced supplies of the gas commodity.

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[20] The Commission rightly acknowledged that the circumstances justifying the extraordinary remedy of unilateral contract adjustment were transitional. It afforded the conversion right only to firm sales customers on the date a pipeline becomes subject to Order No. 436. 18 C.F.R. § 284.10(b); J.A. 440-41. Any customer entering into a sales agreement thereafter will have had the option of nondiscriminatory access by virtue of Order No. 436; accordingly, it will be held to such a commitment. *See id.*

[21] The spot market is, of course, not adequate as an exclusive source of gas for an intermediary selling to non-fuel-switchable consumers. But even a price of $2.50 for gas under long-term contracts (the price available as of mid-1986, *see supra* part I) would represent a saving over the pipelines' embedded contract price. The latter includes not merely the average price being paid by pipelines at the wellhead (about $2.50 as of mid-1986, accordingly to FERC, *see supra* part I), but also the build-up in take-or-pay liability deriving from reduced takes of higher-priced gas.

> Thus, they will no longer be dependent on a single merchant for their gas supplies. . . .

J.A. 407-08. *See also* J.A. 424 ("only through conversions can sole-supplied customers have access . . . to the national market"). Failing to provide such an option, FERC concluded, would be "to condone the fundamental form of undue discrimination by monopoly power which the NGA intended to prohibit." J.A. 426.

Thus while the CD conversion option partially denies pipelines the benefits of their contracts, it does so only because those contracts are vestiges of their monopoly power, and only in order to correct the consequences of that power. This action therefore conforms to the purposes of the NGPA. In *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709 (1986), the Supreme Court declared that enactment of the NGPA left as the "aim of federal regulation . . . to assume adequate supplies of natural gas at fair prices," *id.* at 716, and referred to Congress's "determination that the supply, the demand, and the price of high-cost gas [the type at issue there] be determined by market forces," *id.* at 716-17. Congress's continued concern for the market power of pipelines is expressly reflected in NGPA § 601 (b)(1)(E), providing that the price of gas purchased by a pipeline at the wellhead from its affiliate is deemed just and reasonable only to the extent that it does not exceed independents' prices in comparable sales.

Thus it would appear that the Commission has been correct in its belief that under § 311 it should assert "the traditional regulatory approach in areas where it is needed to protect the public from market dominance by natural gas companies." J.A. 271. Provision of the CD conversion option for customers of pipelines offering § 311 transportation properly implements that view. Any principle quashing the Commission's chosen remedy would seem to block pro-competitive regulatory reform and run counter to a long judicial tradition favoring agency devel-

opment of whatever pro-competitive policies are consistent with the agency's enabling act. *See, e.g., Gulf States Utils. Co. v. FPC*, 411 U.S. 747, 760 (1973); *Denver & Rio Grande W.R.R. Co. v. United States*, 387 U.S. 485, 492-93 (1967).

CD conversion may to a degree shift the costs of overpriced gas and take-or-pay liability to those pipeline customers least able to switch to reliance on the wellhead market. But circumstances limit the pipelines' power to shift the costs. Any customer of a pipeline electing to provide transportation under Order No. 436 has, by definition, the power to go out into the market to secure gas and unbundled transportation. That strategy has its costs—including, of course, the management costs of negotiating and coordinating long-term supplies, or fees to brokers for doing so. But these costs form the ceiling on what pipelines may charge. Accordingly we see no basis for rejecting FERC's conclusion that the cost-shifting risk was tolerable.

We accept FERC's conclusion that the relevant factors under § 311 tilt in favor of the CD conversion option.

C. *Adequacy of the Commission's Reasoning in Support of CD Reduction.*

Several LDCs attack the Commission's authorization of CD *reduction*. They contend primarily that it failed to meet the "substantial evidence" requirements of § 19(b) of the NGA and § 506(a)(4) of the NGPA, which are understood by the parties to be equivalent, in the rule-making context, to the "arbitrary and capricious" standard. *See Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1156 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986); *Mid-Tex Elec. Coop. Inc. v. FERC*, 773 F.2d 327, 338 (D.C. Cir. 1985). This standard requires the agency to "articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs.*

Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

We agree with the challengers that the Commission has failed to develop an adequate rationale in support of CD reduction. Review of the Order on this point is considerably hampered by the Commission's tendency to wrap its justification for CD reduction together with the case for CD conversion. The two almost always appear together, like Rosenkranz and Guildenstern, making it hard to extract the portion of the argument that has any real connection with reduction. This is understandable in terms of the proposals' history. In the NOPR, the Commission offered CD reduction as the sole device by which customers could escape their long-term contracts with pipelines. When the Commission later recognized and embraced CD conversion, its analysis of CD reduction became largely obsolete. Yet it has continued in places to justify it as necessary to effect the goal of providing consumers access to competitively priced gas. *E.g.*, J.A. 407-08. *See also* J.A. 1055-58. If CD conversion is available, however, this justification fails. Below we review various other purposes asserted by FERC, as well as its treatment of the cost-shifting consequences of CD reduction.

(a) FERC argues that "[t]he transitional contract demand reduction and conversion options are essential if the goal of non-discriminatory access to transportation is to be achieved when pipelines operate under the new transportation rules." J.A. 407. In a later passage, rejecting a proposal that it afford only CD conversion, the Commission reasoned that a CD option limited in such a way would restrict customers' access to "transportation services on the same pipeline" and deny them the ability to shop around for unused transportation capacity booked on other pipelines. J.A. 448.

As justifications for CD reduction, these arguments seem peripheral to the problem the Commission set out to

solve in this rulemaking: access to gas competitively priced at the wellhead. CD reduction would of course help each LDC secure access to all the different producing areas of the country, in addition to the ones from which its existing pipeline supplier(s) draw their gas. But the record contains no suggestion that competitive wellhead prices are subject to important regional variations. While easy LDC access to all producing regions would help correct or prevent regional price variations, the Commission makes no argument that any such variations pose so great a problem as to require such drastic action as 100% CD reduction.

Of course, competition among pipelines in transportation services may well be expected to engender lower prices (at any given level of service quality). If so, it would fulfill the general consumer-benefit purposes of the Order. But the Commission does not spell out any such arguments. Moreover, any analysis along these lines would trigger attempted rebuttals, essentially based on the view that in a monopolistic or oligopolistic industry unrestricted consumer choice may lead to duplication of capacity and higher costs for consumers. Without assessing the validity of those arguments or the Commission's authority to adopt rules moving the industry towards more competition in transportation, we simply cannot find any Commission effort to justify CD reduction in such terms.

(b) The Commission argues that the levels of sales service that customers have contracted for on a firm basis "may no longer correspond to what they desire to purchase." J.A. 406 (footnote omitted). The Commission found that this imbalance between actual needs and contracted-for capacity has caused at least two problems. First, the discrepancy results in an undesirable inequity as "on some systems, interruptible transportation is *as a practical matter* virtually the same quality of service as firm," though available at lower rates. *Id.* (emphasis

in original). Second, the discrepancy also has the effect of unnecessarily denying firm service to some potential users, making the reduction option necessary "to allow a freeing up of firm capacity." J.A. 411. *See also* J.A. 417.

While the argument seems highly relevant to CD reduction, it hardly supports the broad remedy adopted. Even in its terms, it refers to a limited portion of the industry. The finding's lack of general application is underscored by the Commission's observations that most firm sales customers need their full contract demand on peak days. J.A. 420. If so, then the obsolescence referred to is clearly far from universal. If such obsolete certificates exist only "on some systems," it is unclear why the Commission believes that an industry-wide solution is needed, especially one that permits *all* LDCs—or rather, all LDCs in their relations with pipelines opting to offer service under Order No. 436—a right to reduce contract demand 100%.

The Commission argues that *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 106 S. Ct. 1969 (1986), allows it to make § 5 determinations generically. J.A. 412. True but irrelevant. Neither *Wisconsin Gas* nor any other case of which we are aware supports an industry-wide solution for a problem that exists only in isolated pockets. In such a case, the disproportion of remedy to ailment would, at least at some point, become arbitrary and capricious. This is not to say, of course, that the Commission could not use generic rules to identify a limited class of LDCs to be entitled to reduce CD when special conditions are present. But here the Commission has said nothing to link the asserted obsolescence of CD levels to the broad class of purchasers made eligible.

(c) Responding to the complaints of some LDCs that the CD reduction option will force them to bear an additional share of pipelines' capital costs (*i.e.*, the costs now

borne by the customers that will exercise the option), the Commission asserts that customers are likely to seek little net CD reduction. J.A. 420. Accordingly there will be little net change, nationwide, in aggregate recovery of costs. *Id.*

The improbability of major *aggregate* cost-shifting, however, provides little answer to the concerns of captive customers of pipelines that are likely to lose out in the competitive race. While the Commission might justify the loss of such a captive by reference to potential aggregate gains, it has neither confronted the problem nor developed in any detail its reasons to expect the net gains.

D. *Insufficiency Under MPC III.*

Maryland People's Counsel argues that under the principle established in *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) ("*MPC III*"), the Commission was required to afford firm customer an *immediate* option to convert any purchase obligation *completely*.[22] We find the claim unpersuasive.

In *MPC III* this court addressed the validity of certain "special marketing programs" ("SMPs"), successors to the SMPs held invalid in *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) ("*MPC I*"). The SMPs reviewed in *MPC I* authorized the following approach to the mounting problem of high gas subject to high take-or-pay burdens: A producer would resell, at market rates, high-cost gas previously committed to a pipeline. A limited class of persons was eligible to purchase, and that class excluded captive consumers. The producer would credit the pipeline's take-or-pay liability for the sale, and the pipeline would transport the gas to the new purchaser. This court held the program invalid because it excluded captive consumers from the class of

[22] MPC does not challenge the phase-in of CD reduction.

eligible new purchasers, without adequate consideration of possible anti-competitive and anti-consumer consequences. FERC then amended the program to permit anyone with a firm contractual entitlement to purchase a pipeline's gas to nominate up to 10% of its contract demand to be purchased under the SMP. Thus the second-generation SMPs gave "captive" customers access to gas at competitive wellhead prices, but only up to the 10% figure. This court overturned the second-generation SMPs, finding them to be "of a piece with" the first. *MPC III*, 768 F.2d at 455.

We think that MPC finds more in *MPC III* than it contains. The Commission there made no effort to justify the 10% option in the second-generation SMPs by reference to classical "grandfathering" values. Here, by contrast, it invokes those values emphatically and we think plausibly, arguing that the pipelines require time to adjust to the new dispensation, particularly to resolve the take-or-pay problems presented by the producer-pipeline contracts. J.A. 1152. The specific phase-in period and percentages and election procedures resulted from detailed consideration of various options.[23] *See* J.A. 1145-55. In the event that the Commission modifies its disposition of the producer-pipeline contracts in light of our treatment of the take-or-pay issue or for any other reason, however, the Commission may wish to reconsider the phase-in of the conversion option.

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[23] We note that the Commission never explicitly responded to the proposals by the Department of Public Service of the State of New York that LDCs be required to give notice of their future gas purchase plans, with some sort of sanctions for deviation from projections. The Commission may have believed that its discussion of the need for customer flexibility addressed this issue. Arguably it did; the cursory response in FERC's brief did not address the issue of what the Commission had considered in the rulemaking (as opposed to what counsel later thought). FERC Brief at 104-05 n.1. On remand explicit consideration of the suggestion would eliminate a potential problem.

V. Producer-Pipeline Contracts

As noted above, certain contracts entered into by producers and pipelines between 1977 and 1982 have been at the root of the Commission's endeavor in Order No. 436. These problem contracts provide for prices far in excess of current market levels. They contain take-or-pay clauses requiring the pipelines either to purchase a specified percentage of the producer's deliverable gas or to make "prepayments" for that percentage anyway. The contracts typically permit the buyer to recoup prepayments by applying those amounts to subsequent "takes" of gas occurring within a limited period after prepayment. *See* 18 C.F.R. § 154.103 (mandating that purchase contracts for gas to be transported in interstate commerce carry a minimum five-year make-up period).

Although all parties refer to the problem posed by these contracts as the issue of take-or-pay, it is the combination of high prices with take-or-pay clauses that causes the difficulty. A 100% take-or-pay contract for gas priced at $1.00 per Mcf would usually cause the purchaser no trouble; gas purchased at the wellhead for $5.00 per Mcf, however, cannot be resold at that price (plus normal transportation mark-ups).

Between 1977 and 1982 the pipelines "rolled in" high-priced gas with low-priced gas (the latter largely due to wellhead ceilings imposed under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)), selling at an average price that was competitive with alternative fuels. But drops in the price of the latter exposed the pipelines to intense market pressure. This was soon reflected in reductions in the wellhead price for newly available gas (*i.e.*, gas not hitherto subject to contract). Pipelines reduced their takes of high-priced gas, and in 1983 prepayment liabiliites for the period between 1982 and 1985 were predicted to reach $7 billion. J.A. 301 & n.34.

At the heart of the industry's immediate problem is the discrepancy between the average cost of gas that pipelines have under contract and the much lower price of gas now available at the wellhead. The essence of that discrepancy is the same whether the pipelines buy overpriced gas and sell it at a loss, or decline to buy such gas and thereby incur take-or-pay liabilities. The price discrepancy represents a sunk loss of billions of dollars (doubtless reflected in actual drilling expenses). At issue among the parties is who should bear it. All actors in the natural gas industry—producers, pipelines, LDCs and consumers—are candidates for this dismal position. There is one exception: fuel-switchable users, who can employ the cheapest fuel competing with gas and thus cannot be induced to pay more than the current competitive price.

By enabling pipeline customers (and some end users) to obtain gas at current wellhead prices and thus escape the supra-competitive contract prices, Order No. 436 appears to relieve consumers from the threat. Conversely, it heightens the likelihood that pipelines will play the fall guys. Considered in this section of the opinion is whether FERC's lack of direct action as to the uneconomic contracts is permissible, particularly in light of Order No. 436's shift in the balance of forces.

A. *The Commission's Prior Activity and Its Inactivity in This Proceeding.*

In April 1985, shortly before issuing the Notice of Proposed Rulemaking (the "NOPR") that culminated in Order No. 436, the Commission issued a policy statement on the regulatory treatment that it would give payments made by pipelines to extinguish take-or-pay liabilities (referred to as "buy-out" payments). *Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations*, 50 Fed. Reg. 16,076 (1985) (codified at 18 C.F.R. § 2.76). The policy statment provides: (a) take-or-pay buy-out payments are not counted

toward NGPA price ceilings (*i.e.*, contracts to buy gas at NGPA ceilings do not breach the ceilings when the pipeline pays the producer in exchange for relief from take-or-pay obligations); (b) pipelines may file to include buy-out payments in their rate bases; (c) the method of cost recovery and the allocation among customers will be determined on a case-specific basis; (d) customers will maintain their NGA § 4 right to question the prudence and apportionment of buy-out payments; and (e) where the take-or-pay buy-out covers "jurisdictional" gas,[24] FERC will handle requests for the certificate amendments or abandonments terminating the producer's legal obligation with respect to such gas on an expedited basis.

Subsection (a) removes one potential difficulty to take-or-pay settlement (the price ceiling issue) and subsection (b) holds out to the pipeline the possibility of recovering the cost. Subsection (e) promises a reduction in red tape. Otherwise the policy is pretty noncommittal, and, more important, does nothing whatever to prevent the cost from flowing downstream to consumers.

The NOPR proposed more drastic action. It would have created "a rebuttable 'safe harbor' presumption of prudence for certain one-time payments made to extinguish all minimum payment or purchase obligations in certain qualifying contracts." J.A. 529. Qualification would require that the buy-out payment not exceed some percentage of the take-or-pay liability discharge. (The Commission did not specify the percentage in the NOPR. *See* J.A. 536-37.) The responses to this proposal were overwhelmingly negative and reflected a fear that the

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[24] The *Phillips* decision found wellhead sales of gas for resale in interstate commerce to be within the Commission's NGA jurisdiciton. The NGPA removed some instances of existing wellhead sales from the Commission's jurisdiction, and provided, in effect, that its jurisdiction would extend to no future ones except for sales from the outer continental shelf. *See* NGPA § 121, 15 U.S.C. § 3331 (1982).

safe harbor would merely establish a floor for take-or-pay settlements. J.A. 529-40. FERC regarded these complaints as valid and withdrew the safe harbor proposal.

FERC also considered a number of alternate proposals for dealing with the take-or-pay problem. Most prominent of these were proposals that FERC (a) directly invoke its power under § 5 to set aside the take-or-pay clauses of contracts for jurisdictional gas,[25] *see* J.A. 330-33, 1119-21, or (b) condition producer access to Order No. 436 transportation on the granting of take-or-pay relief, J.A. 381-83, 1065-74.[26] FERC rejected

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[25] No party here presents any argument for a view that FERC could exercise its § 5 power directly to modify non-jurisdictional wellhead contracts.

[26] A broad coalition of pipelines and LDCs also advances two less prominent proposals made and rejected during the rulemaking. Brief of Indicated Petitioners and Intervenors on Take-or-Pay Contracts Issue at 31 & n.1. First, petitioners contend that certain take-or-pay provisions in wellhead sales contracts might be deemed in violation of the NGPA. For example, the Commission might find that a contract that provided for sale at the NGPA ceiling *and* allowed a producer to keep take-or-pay prepayments even after it has resold the gas to another party, was in effect a contract for sale at a price in excess of the NGPA ceiling. *Id.* We find this premise somewhat improbable. In enacting the NGPA ceilings, Congress must have been aware that producers and pipelines would incorporate these ceilings into long-term contracts, and that the contracts would include remedies for producers. Obviously the remedial rights would constitute value. If any such value put into breach of the NGPA a contract nominally at the NGPA ceiling, the NGPA would provide a most uncertain guide. Congress may well have supposed that state rules against penalty clauses would suffice to prevent exorbitant remedial provisions. Even assuming *arguendo* that clauses restricting recoupment would violate NGPA ceilings, we do not believe that FERC was obliged to consider the issue in this proceeding in the absence of reason to believe that the economic value of these obligations forms a major portion of the discrepancy between pipeline average contract prices and the wellhead price for newly available gas. *See Motor*

these proposals. Concluding that further regulatory action on problem contracts was neither necessary nor desirable, it made only a trivial adjustment in the April 1985 policy statement.[27]

Virtually all parties other than producers attack FERC's refusal to directly address the producer-pipeline contracts. The essential thesis is this: (1) Order No. 436 denies pipelines much of their leverage over producers—the threat to refuse a producer transportation of new gas when the producer refuses to compromise liabilities under old contracts—at excessive prices. (2) Many pipeline customers will take advantage of open access and CD conversion to escape from dependence on their pipeline suppliers. (3) The escapes will have a spiralling effect—as each additional LDC drops bundled service the gas cost burden will grow, driving still others off. (4) The only LDCs who will remain as pipeline sales customers will be the least nimble—those for whom it is most costly to develop secure supplies from non-pipeline sources. (5) As a result, the consumers who purchase from these LDCs will be stuck with the burden of the overpriced gas, thus defeating the purpose of the Order

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Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 51 (1983).

Second, petitioners suggest that the Commission require pipelines to file tariffs expressing a "cutback policy," pursuant to which the pipeline would not buy gas priced above some specified figure. Brief of Indicated Petitioners and Intervenors on Take-or-Pay Contracts Issue at 31 n.1. If such tariffs were to be legally binding on producers, they would, as the Commission argued, *see* J.A. 332, essentially substitute FERC price controls for the wellhead market, a move clearly forbidden by the NGPA. *See Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709, 716-17 (1986). To the extent that such tariffs would not bind producers, it is hard to see what they would accomplish.

[27] FERC expanded § 2.76(e) to provide that interstate pipelines participating in a take-or-pay settlement shall be deemed to have waived any objection to the producer's application for abandonment.

and violating the consumer-protective purposes of the NGA. *See, e.g., Atlantic Ref. Co. v. Public Serv. Comm'n*, 360 U.S. 378, 388 (1959); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944). Further, FERC's inaction will permanently distort the structure of the natural gas market: by creating an artificial advantage for unbundled transportation service, it will cause the pipelines' merchant role to atrophy, despite the greater efficiency of bundled service. (The greater efficiency derives from pipelines' incurring lower transaction costs in providing a full range of service, including load-balancing service, than would any non-pipeline entity.)

We conclude that FERC's decision to do nothing more than reaffirm the April 1985 policy statement reflects questionable legal premises and fails to meet the requirement of "reasoned decisionmaking." Accordingly, we reverse and remand for further proceedings.

B. *Analysis of FERC's Decision.*

FERC made several contentions in support of its decision against further direct action on the uneconomic contracts. First, it determined that further action was not necessary because Order No. 436 would not cause take-or-pay liabilities to increase, or if it did, the increased liabilities could be shuffled from the pipelines to consumers. Second, FERC invoked a number of policy reasons generally militating against regulatory relief for pipelines. Third, FERC found flaws with the leading alternative proposals advanced by participants in the rulemaking, namely that it use its § 5 power to modify contracts involving jurisdictional gas, and that it condition producer access on the granting of some measure of take-or-pay relief (or allow the pipelines to impose such conditions). We address each of these findings in turn.

1. *Lack of need for additional steps.*

a. *Likely effects of Order No. 436 on take-or-pay build-up.* FERC accepted an industry estimate of about

$7 billion in take-or-pay obligations, J.A. 301-02, though noting the much smaller sum included in pipeline rate bases, J.A. 831, 1069-70. But it made no detailed evaluation of what proportion of these payments—or ones to be made in the future—the pipelines could recoup by later "takes" of gas. It found that pipelines had been able to buy-out substantial portions of their liabilities for about 20¢ on the dollar. J.A. 540. It concluded that these prices were reasonable and that buy-outs were sufficiently widespread to represent a reasonable solution to the problem.

FERC also offered several arguments challengingg petitioners' death-spiral scenario for pipeline sales service.

(a) As to the pipelines' loss of a bargaining chip, FERC observes that the nondiscriminatory access and CD reduction/conversion conditions "are not intended to affect such renegotiations or litigation." J.A. 1070. But FERC's intent is not at issue. What is in dispute is the likely consequence of its acts. On that, FERC offers nothing to undermine the challengers' inherently plausible suggestion that these conditions will have an adverse impact on the pipelines' take-or-pay problems.

FERC also alludes to the "voluntary" character of pipeline provision of Order No. 436 transportation. *E.g.*, J.A. 1072. There are two flaws in this. First, refusal of the option may spell bankruptcy: inability to provide blanket-certificate transportation for fuel-switchable users may in current market circumstances cause critical load loss. Of course acceptance of the option may also be fatal. But when a condemned man is given the choice between the noose and the firing squad, we do not ordinarily say that he has "voluntarily" chosen to be hanged.

Second, the argument obscures distinctions between pipelines in the aggregate and alone. To be sure, Order No. 436 gives pipelines an option, blanket-certificate transportation, which as a result of this court's decision

in *Maryland People's Counsel v. FERC*, 761 F.2d 780 (1985) (*"MPC II"*), is not available outside of Order No. 436. But as soon as a single pipeline finds it attractive enough to accept, each competing pipeline will come under competitive pressure to match the first's flexibility. Thus even if only one pipeline actually preferred to use Order No. 436 (hanging rather than being shot), competition might force others—ultimately perhaps all the others—to switch their preference. Thus the Order effectively reduces pipeline ability to face down recalcitrant producers.

(b) FERC argues that the CD conversion/reduction provisions may not injure the pipelines at all.

> [T]he Commission considers it more likely that [the LDCs] will either convert to firm transportation on the same pipeline, or else free up underutilized capacity under uneconomic CDs for use by other customers on the same pipeline. In either case, the pipeline may actually increase throughput and, therefore, gain the net benefits of spreading its fixed costs over greater units of gas service.

J.A. 1068-69.

But customers' conversion to transportation will clearly aggravate a pipeline's ability to resolve the problem of its overpriced gas inventory. Nor can the Order's CD reduction provision be painless: a pipeline would voluntarily agree to release an LDC whenever it had equally profitable business opportunities for the pipeline capacity thus made available; accordingly, the only cases where Order No. 436 *causes* CD reduction will be ones where the reduction does injure the pipeline. FERC's analysis provides no reason to suppose that those instances will be negligible.

(c) FERC contends that under competitive pressures a pipeline "will seek to adjust its gas purchasing practices so as to lower its weighted average cost of gas

to all customers." J.A. 1069 (emphasis in original). This reasoning assumes away the problem of the uneconomical contracts to which pipelines are presently bound. All FERC does here is to admit that Order No. 436 dramatically increases the consequences of not getting out from under an uneconomical contract. It seems to confuse the pipelines' *incentives* to renegotiate contracts with their *ability* to do so.

(d) FERC suggests that "[a] pipeline may determine that certain of its existing business arrangements make participation in the new rules unwise or undesirable," and suggests possible alteration of the pipeline's "leveraged capital structure" and "the extent of its non-pipeline business interests." J.A. 1067. To the extent that this implicitly recommends some sort of spin-off of assets or borrowing increase, preparatory to bankruptcy, it seems unrealistic in light of market conditions, the rules against transfers in fraud of creditors, and "pierce-the-corporate-veil" principles.

(e) FERC finds two affirmative advantages for pipelines in Order No. 436. First, the Order affords producers a procedure for expedited "abandonment" (*i.e.*, extinction of the legal commitment of the gas to the seller named in the producer's certificate under the NGA) where a take-or-pay settlement has been reached or where a producer experiences substantially reduced takes without payment. 18 C.F.R. §§ 2.76(e), 2.77. In the latter case, it argues, abandonment will enable the pipeline to invoke contract defenses against a producer that resells the gas, specifically mitigation of damages. J.A. 1071-72. It is unclear how useful this may be, for the pipelines' whole problem is the excess of the contract price over the current market price. That differential is the source of pipeline vulnerability, and expedited abandonment does little or nothing to cure it.[28]

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[28] We reject the American Gas Association's attacks on the expedited abandonment provisions. These provisions merely out-

Second, the Commission suggests that Order No. 436 might aid the resolution of take-or-pay problems by not precluding

> any gas shipper, whether end-user, LDC, or independent broker, from negotiating *on its own behalf* a condition in a "self-help" gas sales contract which would require the producer-seller to grant take-or-pay relief to the shipper's pipeline supplier before the shipper takes delivery of the gas.

J.A. 1073-74 (emphasis in original). Assuming FERC will stand by the underscored phrase, the scenario seems most unlikely. No reason appears why any of those persons would, in its bargaining with a supplier, sacrifice anything of value in order to secure a benefit for the pipeline. (Nor would the supplier agree to it without securing something in exchange.)

In sum, FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability, and its tendency to elevate into affirmative benefits what are at best palliatives, seem impossible to square with the requirement of reasoned decisionmaking.

b. *Pipeline ability to shift costs downstream.* The Commission suggests that pipeline complaints about Order No. 436 are undercut by its having reserved the ability to shift costs downstream to customers.

> To the extent a pipeline in fact incurs additional take-or-pay liability due to transportation services under Order No. 436, nothing in Order No. 436 is intended to preclude the Commission from determining the appropriate allocation of revenue responsibility among the pipeline and its customers in an in-

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line circumstances in which FERC will proceed in an expedited manner. They do not change FERC's policy as to when abandonment is in the public interest, and we have already upheld FERC's power to streamline its procedures in this manner. *See supra* [illegible]

dividual rate case filed to reflect the adjustments in sales and transportation service.

J.A. 1070-71.

While it is unclear what weight the Commission attaches to this possibility, it seems important to call to mind two legal limits on the Commission. On one hand, simply moving costs downstream to customers must at some point conflict with the Commission's duty to "adequately attend[] to the agency's prime constituency—the consumers whom the [NGA] was designed 'to protect . . . against exploitation at the hands of natural gas companies.'" *MPC II*, 761 F.2d at 781 (quoting *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944)). On the other hand, the Commission's power to directly restrict pipelines from passing costs through is limited: it can limit passthrough of gas purchase costs made in compliance with the NGPA only if the payments arose out of "fraud or abuse," NGPA § 601(c)(2), 15 U.S.C. § 3431(c)(2) (1982), and it can limit passthrough of other costs (including, under the Commission's view, take-or-pay settlement costs), only to the extent not "prudently" incurred, *see* 18 C.F.R. § 2.76(d).

Despite these constraints on the Commission's power to limit passthrough *by decree*, it has considerable ability to protect consumers by bringing about *market conditions* that prevent a pipeline from passing costs forward. The NGPA's legal limits on restricting passthrough clearly do not bar rules tending to generate such market conditions. *Cf. supra* part IV.B. Indeed, that is the principle underlying Order No. 436. At least two other factors, however, restrict the Commission's room for maneuver here. (1) To the extent that the Commission allows gas costs in a pipeline's rate base for transportation purposes, a possibility that it seems to leave open, J.A. 423, the costs will flow through the customers despite open access. (2) To the extent that it allocates large take-or-pay liabilities exclusively to gas costs, it seems likely to

eradicate the pipelines as merchants, for under such a rule all customers would convert their entire contract demand, except for a limited class of customers: those who find it unusually costly to arrange their own non-pipeline sources of supply or who are pressured by state regulatory commissions to adhere to reliance on pipeline supplies.

In sum, the Commission seems to exaggerate passthrough to customers as a solution to the problem of uneconomic contracts. If Order No. 436 works as intended, economic constraints will make passthrough impossible, except for customers—likely not accounting for a large proportion of the interstates' total gas sales—that are exceptionally sclerotic about purchasing gas from brokers or producers.

2. *Policy considerations militating against any intervention.*

In refusing to modify producer/pipeline contracts, FERC noted that such action would "raise extremely serious questions regarding the ability of private parties in the gas production industry to rely on private contracts as a tool for structuring basic economic relationships." J.A. 332. In its brief, moreover, FERC invokes the need to be sensitive to the congressional policy decision, inherent in the NGPA, "to move toward a deregulated gas commodity market." FERC Brief at 130-31. As the Supreme Court has recently stated, "To the extent that Congress denied FERC the power to regulate affirmatively particular aspects of the first sale of gas, it did so because it wanted to leave determination of supply and first-sale price to the market." *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board*, 106 S. Ct. 709, 717 (1986).

The Commission also invoked the closely related policy of holding pipelines accountable for their decisions in order to induce them to act more in the manner of firms in a competitive industry. J.A. 44-48. Although the context was a discussion of risk allocation as between pipe-

lines and their customers, FERC's reliance on it in that context underscores FERC's commitment to the policy of nurturing a competitive wellhead market.

In essence FERC argues that the pipelines' subjection to regulation is hardly, in itself, a reason why they should be able to escape contractual liability more readily than unregulated firms. Like those firms, pipelines are able to invoke the doctrines of impossibility and impracticability and to assert defenses under *force majeure* clauses.[29] They may also be able to persuade their suppliers to accept contract adjustments by appealing to the latters' long-term business interests. These steps would be the only recourse open to an ordinary middleman in a competitive market who had entered into unlucky or improvident contracts. FERC suggests that pipelines should not enjoy an extra means of escape.

FERC invokes the same principle in distinguishing producer-pipeline contracts from those between pipelines and LDCs, which it proposes forcibly to adjust pursuant to the CD conversion and reduction options. First, FERC notes that, unlike a provision granting pipelines relief from uneconomical supply contracts, the CD conversion/reduction option is essential if Order No. 436 is to carry out its fundamental purpose of providing all parties meaningful access to low-cost gas. *See* J.A. 414-25, 1119-21. *See also Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) (*"MPC I"*); *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*"MPC II"*); *Maryland People's Counsel v. FERC*, 768 F.2d 450 (D.C. Cir. 1985) (*"MPC III"*). Second, FERC highlights the fact that the troublesome pipeline-producer contracts are largely "straightforward commercial agreements" while pipeline-consumer con-

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[29] FERC has asserted that nothing in Order No. 436 "is intended to abridge the rights and obligations regarding take-or-pay liabilities under contracts between those pipelines and their suppliers, including any right to raise *force majeure* as a defense in an appropriate case." J.A. 1231.

tracts are heavily regulated "utility-type 'service agreements.'" J.A. 1120.

FERC's policy arguments in favor of subjecting pipelines to the pressures of a competitive market seem powerful and well grounded in the statutes it is authorized to enforce. Lest the Commission on remand place undue weight upon them, however, we must note some limits. Most important, producers' access to transportation under Order No. 436 is itself dependent on government intervention. To condition that access on some producer cooperation in disposing of outstanding contracts is hardly identical to raw governmental abrogation of the contracts. Second, while the middleman buying and selling in competitive markets will bear the risk associated with his bad luck or improvidence, the pipeline's market power allows it to pass some of that burden forward. As noted above, some portion of that ability will remain despite "open access" under Order No. 436 and despite FERC's view that passthrough of buy-out costs is permissible only where they have been prudently incurred. Third, the pipelines have been caught in an unusual transition. They entered into the now uneconomic contracts in an era when government officials berated pipeline management for failures of supply and constantly predicted continuing energy price escalations. Moreover, as sales and transportation were then wholly bundled, and unregulated pipeline gas trading affiliates were unknown, there was no way that a pipeline could generate direct profits on the gas-trading component of its business. Thus, their being abruptly and retroactively subjected to the downside risk is at least jarring. *See* Carpenter, Jacoby & Wright, *Adapting to Change in Natural Gas Markets*, in *Energy, Markets & Regulation: Essays in Honor of M.A. Adelman* 1 (1986) (tracing evolution of natural gas pipelines' exposure to risk). For the reasons already noted, *see supra* part IV.B., the resulting equities are not enough to block necessary pro-competitive reforms. But they are not weightless.

3. *Reasons for rejection of specific proposals.*

a. *Section 5 action against jurisdictional contracts.* In rejecting the proposal that it invoke its § 5 power directly to set aside jurisdictional contracts with troublesome take-or-pay provisions,[30] the Commission reasoned that because such a remedy would be incomplete, its use would be both inequitable and inefficacious. As a result of the NGPA, the proportion of wellhead sales that are jurisdictional is steadily declining. "It would be inequitable," the Commission said, "to allow pipelines to reduce their takes only under contracts still subject to the Commission's NGA jurisdiction, particularly because many of the problem contracts are not subject to the Commission's jurisdiction." J.A. 1121. If in fact jurisdictional contracts account for only a small proportion of the troubling price discrepancy, we can well understand the Commission's viewing the invocation of § 5 as unpromising—at least unpromising enough to justify its proceeding with open access and deferring the abrogation approach. Elsewhere, however, the Commission states that "the bulk of high-cost 'problem' contracts without 'market-outs' may be those entered into prior to 1982 involving offshore gas regulated under NGPA section 102 [*i.e.*, jurisdictional]." J.A. 1072. *See* NGA § 601(a)(1)(B), 15 U.S.C. § 3431(a)(1)(B) (1982) (preserving NGA jurisdiction over gas from Outer Continental Shelf). On remand FERC must make clear the extent to which contracts for jurisdictional gas account for the basic economic problem.

In addition to the ambiguity in the factual underpinning of FERC's argument, we have some difficulty with the claim of inequity. In the NGPA Congress selected a particular device for bringing about a transi-

[30] The Commission has no power under § 5 to set aside or modify clauses in producer contracts relating to non-jurisdictional gas. *See Pennzoil Co. v. FERC*, 645 F.2d 360, 380-83 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

tion from the *Phillips* world, with all wellhead interstate sales for resale subject to Commission jurisdiction, to a quite different world, with only Outer Continental Shelf wellhead sales jurisdictional. The device was primarily one of perfectly standard grandfathering. Whatever inequity may flow from some producers suffering the consequence of failing on the wrong side of the line, while others fall on the right side, appears to be no more than the usual result of grandfathering.

The above discussion may not accurately capture the Commission's concern. It has, rightly, we think (*see supra* pp. 87-89), placed great weight on the congressional determination that market forces should operate freely at the wellhead. Even for jurisdictional contracts, moreover, Congress has provided that prices at or below the NGPA ceilings are "just and reasonable." NGPA § 601(b), 15 U.S.C. § 3431(b) (1982). Thus FERC is clearly barred from setting sub-NGPA ceilings on jurisdictional wellhead sales. Assuming that the Commission may find specific take-or-pay percentages to violate § 5, *see Columbia Gas Transmission Corp.*, Opinion No. 204, 26 F.E.R.C. ¶ 61,034, at 61,120 (1984), *aff'd in part and reversed in part sub nom. Office of Consumers' Counsel v. FERC*, 783 F.2d 206, 229 (D.C. Cir. 1986), it may well fear that action against take-or-pay provisions without regard to price would be both ineffective and inequitable: ineffective because it would not reach many contracts that are deleterious only because very high price provisions combine with otherwise harmless take-or-pay clauses; inequitable because it would restrict contracts that are harmless despite high take-or-pay provisions.

The Commission has not expressed the meaning of its reasons for inaction on jurisdictional contracts clearly enough for us to determine the legality of its analysis.

Accordingly, it should on remand reassess its refusal to act under § 5.[31]

b. *Conditioning producer access.* In refusing to condition producer access on cooperation in solving take-or-pay issues (or to allow pipelines to impose such a condition), FERC asserts that it would be unduly discriminatory for a pipeline to refuse transportation service under Order No. 436 "merely because the producer and pipeline cannot agree on take-or-pay relief in another contract." J.A. 1073. It believes that such a refusal would discriminate not only against the producer-seller but also against the would-be buyer to whom the pipeline would have carried the gas but for the proposed condition. *Id.*

Insofar as the argument simply states that such a refusal would violate the anti-discrimination concept manifested in Order No. 436 itself, it obviously provides no justification for FERC's having chosen to so delineate its anti-discrimination concept. Insofar as it interprets § 5's prohibition of "undue discrimination," the analysis seems very unpersuasive. Given that the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure, J.A. 315, it eludes us why pipeline denial of access to producers that stand on the letter of their contract rights should be viewed as unduly discriminatory. It is clear that § 5 does not prohibit every distinction. *See Saint Michaels Utilities Comm'n v. FPC*, 377 F.2d 912 (4th Cir. 1967); *cf. Texas & Pac. Ry. v. ICC*, 162 U.S. 197, 218-19 (1896) (one of long line of cases finding Interstate Commerce Act's prohibition of dis-

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[31] We note that the effectiveness of a solution may be a relative matter. If the Commission on remand should adopt some access condition that realistically promises to solve the problem of troublesome producer-pipeline contracts, that would alter the context of its determination whether specific take-or-pay clauses in jurisdictional contracts are unjust or unreasonable.

crimination not to bar every rate differential). FERC offers no reason why it views this one as beyond the pale.

The Commission's response may arise out of a concern that any such condition would give pipelines a veto power over transportation of each producer's gas. We think such a fear underestimates the Commission's power to impose both procedural and substantive limits on pipeline use of any conditioning power. First, it could obviously require that the pipeline specify the allegedly offending contracts, thus preventing pipelines from transforming the condition into one allowing them unlimited discretion. Second, without even addressing the nuances of which price and percentage terms are truly objectionable, it could limit the condition rule to disputes over contracts entered into before some date; it could select the date, for example, as of which it had become reasonably clear that the NGPA's premise—the notion that the market price of gas would never fall below NGPA ceilings—had ceased to be valid. Third, it could explore the possibility of developing rules that would identify the price and take-or-pay provisions that unduly thwart the Commission's purpose in Order No. 436 and its duty under the NGA to protect consumers.

We do not mean to suggest that the Commission need consider any of the options discussed. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Ins. Co.*, 463 U.S. 29, 50-51 (1983). Our point is simply that the Commission seems not to have made much of a case against a condition of the sort proposed. Given the serious threat to Order No. 436's fulfillment of the Commission's statutory goals, we think that rejection of such a proposal requires more explanation than the Commission has offered.

Finally, the suggestion that any access-conditioning rule would unduly discriminate against customers seems to us at best ill-developed. Generally speaking, one might expect customers and consumers to be unanimous in fa-

voring any exercise of FERC power that would help to eradicate the supra-market contracts. Many customers and customer representatives join the brief demanding greater action on take-or-pay; no gas purchaser opposes it. Of course a purchaser that arranged for a bargain purchase of gas would be disappointed to see the deal founder on the producer's take-or-pay recalcitrance. But, recognizing the reasons underlying the barrier, it would be likely to accept the occasional burden as a just one.

Some producers support FERC's rejection of access-conditioning by invoking the concept that with such a condition the Commission would be doing indirectly what it is forbidden to do directly—*i.e.*, regulate wellhead prices. The Commission itself at one time appeared to make an essentially similar argument, when it said "there is a serious question as to whether the Commission has the authority to require a nonjurisdictional party to give up a valid contractual right as a condition to obtaining service." J.A. 381. *See also* J.A. 331 ("It is the Commission's tentative judgment that Congress, through its decisions to ultimately decontrol all natural gas supplies (as old gas is depleted), determined that the workably competitive wellhead market would do a better job of setting such rates for the commodity than would a utility regulatory body."). But by the rehearing stage FERC had ceased to invoke the position (at least in this form), *see* J.A. 1065-74, and by the time of briefing seemed to repudiate it, FERC Brief at 129. However, since some petitioners invoke the argument, we address it briefly.

That access-conditioning and wellhead price controls might have somewhat similar effects (lower wellhead prices) does not make them the same thing at all. Order No. 436 mandates access in order to solve unprecedented problems in the natural gas market. That access will give producers entirely new market opportunities. Order No. 436 would create these opportunities not because the

statute expressly mandates that producers should enjoy them, but because the Commission believes that such access is a well-designed corrective for practices that it finds unduly discriminatory. If it is appropriate for the Commission to bar refractory producers from the benefits of Order No. 436 in order to fulfill the underlying statutory mandate, then the fact that this constitutes a form of government pressure to reduce prices is itself no barrier.

C. *Conclusion.*

In deciding on inaction, FERC (1) assessed the hazards created by Order No. 436, finding them likely to be nil, (2) invoked certain policy concerns militating against action, and (3) rejected as flawed a variety of alternative proposals suggested during the rulemaking proceedings. Recognizing that the Commission is expert in this area, we nevertheless find its stated legal premises questionable and its factual assessments utterly Panglossian. In contrast, its primary policy concerns seems to us forceful ones. We remand to the Commission to determine, in light of our discussion of its questionable factual and legal premises, to what extent these policy considerations may justify its inaction on the uneconomical producer-pipeline contracts. We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking.

VI. Optional Expedited Certification

Order No. 436 sets out to ameliorate certain anti-consumer and anti-competitive consequences of the Commission's classical approach to certification under the NGA. Before a pipeline may acquire or construct any facilities or offer any transportation or sales service subject to the Commission's NGA jurisdiction, it must obtain a § 7 certificate authorizing the acts. The Commis-

sion must issue such a certificate where it finds that the applicant is able and willing to do the acts and perform the service proposed, and the facility or service is or will be required by the present or future public convenience and necessity. NGA § 7(e), 15 U.S.C. § 717f(e) (1982). Historically, the Commission's approach to certification has entailed an elaborate effort to predict the likely consequences of allowing the proposed service or act. This included the Commission's foretelling—or, more realistically, attempting to foretell—the impact of certification on, for example, shareholders and customers of both the applicant firm and those of any firm whose sales would be displaced. *See, e.g., Atlantic Seaboard Corp. v. FPC*, 397 F.2d 753, 756 (4th Cir. 1968); *Tennessee Gas Pipeline Co.*, 22 F.E.R.C. ¶ 61,174, at 61,294-96 (1983); *Natural Gas Pipeline Co.*, 20 F.E.R.C. ¶ 61,324, at 61,675 (1982), *reh'g denied*, 21 F.E.R.C. ¶ 61,223 (1982), *amended* 21 F.E.R.C. ¶ 61,231 (1982); *Columbia Gulf Transmission Co.*, 37 F.P.C. 118, 131, *reh'g denied*, 37 F.P.C. 591 (1967), *aff'd sub nom., Atlantic Seaboard Corp. v. FPC*, 397 F.2d 753, 757-59 (4th Cir. 1968). The process has been time consuming, *see, e.g., Natural Gas Pipeline Co.*, 30 F.E.R.C. ¶ 61,017 (1984) (Commission approval on January 14, 1985 of application filed June 1, 1982), and costly; it also utterly stifles the sort of quick responsiveness to demand that is associated with competition.

Order No. 436 seeks to stimulate competition and to enhance consumers' access to the wellhead market by making an optional expedited certificate ("OEC") procedure available to pipelines seeking to provide "new service" (*i.e.*, transportation or sales service of a different magnitude or kind than it currently provides, 18 C.F.R. § 157.101(b)(2)) or to acquire or construct facilities to do the same. To qualify for the OEC procedure, a pipeline must meet criteria designed by the Commission to assure that it assumes the full economic risk of the ven-

ture.[82] Applicants who agree to these conditions receive in return the benefit of a rebuttable presumption that the facility or service meets the statutory prerequisites of certification, 18 C.F.R. § 157.104(c), and thus enjoy the possibility of escaping the usual cumbersome hearing, 18 C.F.R. § 157.104(b). Protesters who wish to challenge the certification in a full hearing must raise genuine issues of material fact as to compliance with the statutory criteria.

This facet of the Commission's order has provoked the greatest concern among state commissions and LDCs. These parties fear that pipelines will be able to take advantage of the OEC procedures to obtain all of the facilities and certificates necessary to deliver gas directly to end users, bypassing the LDCs currently making such sales. Such bypass, if it occurs, would at least in the short run reduce the bypassed LDC's volume and thus force either its shareholders or remaining customers to shoulder higher costs (the so-called "cost-shifting" prob-

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[82] *See* J.A. 553. The regulations adopted in Order No. 436 provide that projections of units of service may never be decreased, § 157.103(d)(4), *i.e.*, the pipeline cannot secure a rate increase by demonstrating that service has fallen below expectations; that costs originally allocated to the new service may be shifted only on a showing that they are being incurred for the benefit of other services, § 157.103(d)(8); and that the pipeline may not, for sales service (firm or interruptible), impose any charge tending to guarantee revenue, such as a demand charge or a reservation fee, § 157.103(e).

If the applicant seeks a certificate to provide transportation for others under the OEC procedure it must also apply for a blanket certificate under § 284.221, thereby exposing its entire transportation network to the conditions of Order No. 436, such as nondiscriminatory access and CD adjustment. Once a pipeline has obtained a blanket transportation certificate, it would no longer need case-specific certification. As a practical matter this appears to render the OEC route useful only in obtaining a certificate to provide sales service, or, more importantly, to construct or acquire new facilities.

lem). Accordingly, the state commissions and LDCs attack both the substance of the OEC rule and the procedures established for its application.

A. *Ripeness.*

So far as we know, no pipeilne has yet applied for expedited certification, so that none of the rule's substantive or procedural terms has yet been applied in a concrete setting. Indeed, we may not freely assume that *any* pipeline will ever invoke the option: the rule's criteria may chill all possible applications. Accordingly, we face a preliminary question of whether the challenges to this part of Order No. 436 are ripe.

The functions of the ripeness doctrine are well-established:

> [The doctrine's] basic rationale is to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties.

Abbott Laboratories v. Gardner, 387 U.S. 136, 148-49 (1967). The Court in *Abbott Laboratories* went on to derive from these criteria its well-known test, requiring us to evaluate "both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration." *Id.* at 149.

Petitioners' claims may for ripeness purposes be divided into two classes, loosely speaking the attacks on the rule's substance and those on its procedures. We find the first ripe, the second not. Concerning the substance of the rule, petitioners claim that the Commission in adopting it disregarded values that Congress required it to consider (*e.g.*, impact upon LDCs' residential customers, the need to prevent wasteful investment), make

unsupported assumptions (*e.g.*, that under the rule pipelines would really bear the full economic risk and that LDCs were really in a position to compete with pipelines on an equal footing), and failed to supply adequate reasons (especially for its abolition of a prior policy against bypass). These issues seem fit for judicial review, and we believe that delay in resolving them will impose material hardship on the challenging parties.

In the OEC provisions of Order No. 436, the Commission clearly states that it will consider itself free to certify proposed facilities or service whenever (1) it receives a qualifying application and (2) no opposition is filed. The implication, indeed, is that this will ordinarily be the outcome. Special circumstances seem needed to defeat the application; one relevant factor, for example, is whether the applicant has committed itself to nondiscriminatory transportation under Order No. 436. *See* J.A. 568, 1362. Moreover, the Commission expressly states that in an OEC proceeding it will not allow onto the agenda certain issues formerly cognizable in § 7 hearings: duplication of facilities, the problem of cost-shifting in a bypassed distributor's rates, or impact on local interests generally. FERC Supp. Brief at 6, 8.

This is a reasonably specific, concrete proposition. Action under the OEC regulations appears likely to be virtually as automatic as under the policy statement at issue in *Nader v. CAB*, 657 F.2d 453 (D.C. Cir. 1981), in which the CAB stated that it would not suspend any fare filing that fitted within a band surrounding the fare that a specific formula would produce. We found the policy statement ripe for review (without even considering the "hardship" component of ripeness), noting that the "mandatory language . . . narrowly circumscribes the Board's discretion to suspend air fares" within the prescribed bounds. *Id.* at 456. Though the Commission does not here commit itself to an automatic outcome (*i.e.*, it does not employ mandatory language), it signifi-

cantly circumscribes its discretion. It commits itself to grant applications that meet specific criteria, at least so long as offsetting factors do not appear. And while the Commission has not furnished an all-inclusive list of possible offsetting factors (the list is in a sense open-ended), it has expressly removed from the list many factors that have historically dominated § 7 proceedings. Thus one can state a range of hypotheticals and predict the Commission's disposition with a fair degree of confidence. That some issues are unresolved does not in itself render unfit the ones that the agency has clearly determined. *See Continental Air Lines v. CAB*, 522 F.2d 107, 125-26 (D.C. Cir. 1975).

In some respects, fitness is clearer here than in *Nader*. Not only has the Commission made clear it considers the regulations final and outcomes largely predetermined, *see Continental Air Lines*, 522 F.2d at 125, but the action takes the form of specific regulations adopted after a notice-and-comment rulemaking rather than a mere policy statement.

Moreover, the Commission's decision is reasonably likely to have an effect on the primary conduct and day-to-day affairs of at least some of the petitioners. *Cf. Toilet Goods Ass'n v. Gardner*, 387 U.S. 158, 164 (1967). The creation of the presumption, and the refusal to except instances of LDC bypass, increase the risk that such bypass will occur. That incremental risk clearly gives LDCs an incentive to make immediate adjustments in their business—for example, to attempt to renegotiate their contracts with end users, to lean up their operation in an effort to be more competitive, or to bring their rate structures more closely into alignment with costs. Indeed, in adopting the rule the Commission expressly noted its tendency to create economic incentives to promote economic efficiency. *See* J.A. 561; *see also* FERC Brief at 165. This likely impact on petitioners' primary conduct, coupled with the fitness of the issue for judicial review,

render the Commission's adoption of the presumption ripe for review.

The same cannot be said of petitioners' attacks on procedural aspects of the OEC presumption. These attacks revolve around the thesis that the Commission's procedures may hamper their ability to mount effective attacks on proposed new services. Petitioners argue, for example, (1) that the Commission's creation of a presumption illegally switches the burden of proof from the applicant to protesters (Brief of the State Commission Petitioners on Bypass Issues at 18-22; Brief of United Distribution Companies at 28-29); (2) that the provisions for change of delivery points might in practice allow pipelines to deliver at a previously unauthorized location (thereby entailing bypass possibilities not suggested by the initial OEC application) (Brief of the State Commission Petitioners on Bypass Issues at 34-37); (3) that the Commission procedures would not allow protesters to ascertain facts essential to formulating their objections (Brief of the State Commission Petitioners on Bypass Issues at 37-41; Brief of the American Gas Ass'n at 23-24; Brief of Associated Gas Distributors at 36-37); and (4) that the Commission's provisions for a "noncontested proceeding" might be triggered even in cases where a genuine contest existed[33] (Brief of Associated Gas Distributors at 17-19).

All these attacks share a highly abstract and speculative character. On the first two issues the Commission asserts that petitioners have misread the regulations and are thus attacking phantoms of their own imaginations, *see* FERC Brief at 172-79; its view is certainly not implausible. All the claims seem likely to turn on individualized, fact-specific situations that are not before us. Some conceivable application—or misapplication—of the Commission's "noncontested proceeding" regulations might

[33] Compare § 157.104(b) with § 385.802.

unduly truncate a protester's rights, but that possibility hardly justifies our issuing an advisory opinion on a vast range of possible situations. The claim about possible informaiton gaps suffers the same flaw.

The character of these attacks seems even more abstract and speculative than that of the ones found unfit for review in *Abbott Laboratories*'s companion case, *Toilet Goods Ass'n v. Gardner*, 387 U.S. 158 (1967). There the Court considered regulations allowing the Commissioner of Foods and Drugs to suspend certification service (a necessity for marketing the regulated commodities) whenever a subject of the regulation refused FDA inspectors "free access" to their manufacturing facilities. The Court reasoned that until the regulations were applied it could not know whether or when the Commissioner might order an inspection, or what reasons he might give for doing so. *Id.* at 163. Resolution of the legal issues would turn on the FDA's enforcement problems, the need for supervision, and safeguards for protection of trade secrets. The Court believed that all could be resolved better in the setting of a specific application rather than "the framework of the generalized challenge made here." *Id.* at 164. *See also Association of National Advertisers v. FTC*, 617 F.2d 611, 620 (D.C. Cir. 1979) (finding a challenge to certain Federal Trade Commission procedures unfit for review as it would entangle the court "in an essentially abstract discussion of the [challenged procedures'] potential effects").

Nor do petitioners demonstrate that they would suffer the slightest hardship as a result of our declining immediate adjudication of their claims. Again *Toilet Goods* controls. There the Court argued that the "free access" regulation was most unlikely to affect "primary conduct" —the challengers' behavior in the day-to-day world of negotiating contracts, testing ingredients or compiling records. 387 U.S. at 164. It has been argued that in fact the Court overlooked a likely impact on primary con-

duct, namely, that drug manufacturers might reallocate resources away from development of drugs dependent on secret formulae. *See* Vining, *Direct Judicial Review and the Doctrine of Ripeness in Administrative Law*, 69 Mich. L. Rev. 1445, 1502-04 (1971). Here we see no hazard at all that uncertainty about these procedural flaws could materially alter any of the challengers' decisions about how to conduct their business operations. The connection is far too iffy.

Accordingly, for want of both fitness for review and any material hardship to the challengers, we dismiss the procedural claims as unripe. We now turn to the merits of the petitioners' challenge to the Commission's creation of the presumption.

B. *Legality of the Presumption.*

The OEC aspect of Order No. 436 enables pipelines to make an occasional end-run around the costs and delays of ordinary certification. It establishes criteria aimed at assuring that the applicant will bear the full economic risk of the venture. The Order takes the position that, if the applicant agrees to those criteria, and no offsetting factors appear, the various public interest concerns explicit or implicit in § 7 will be satisfied.

1. *Alleged disregard of legally relevant factors.*

Petitioners' primary claims revolve around the idea that the Commission's innovation disregards important factors that Congress intended the Commission to consider. Most prominent among these allegedly neglected factors are (1) the risk of waste through construction of duplicative facilities and (2) adverse impact on the customers of bypassed LDCs.[34]

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[34] Petitioners appear to make no claim that the Commission was not procedurally free to use a rulemaking to identify in advance the criteria on which it would grant or deny certification. It is, of course, far too late in the history of administrative law for any such

It seems clear that among the congressional purposes in providing for certification was "to prevent uneconomic extensions and waste."[35] But it is equally clear that Congress has adopted no general policy against firms taking *their* (*i.e.*, their investors') money and applying it to projects that may prove unjustifiable in terms of the ultimate return. What generates special concern about wasted investment in the context of a regulated monopoly is that the ultimate bearers of the risk may be the consumers rather than the investors. For example, investment in a particular stretch of pipeline typically goes into the regulated firm's rate base, its cost to be recovered out of rates charged all the firm's customers. Since regulation supposedly holds the rates below profit-maximizing levels, the firm has no difficulty collecting the charge if the regulators authorize it. And it can do this even though the new investment proves a complete loser.

This risk-shifting under regulated monopoly contrasts sharply with conditions in either a competitive or an unregulated industry. Where competition prevails, a firm cannot compensate itself for losses on one venture by raising prices on other lines of business; if it tried to do so, competitors could profitably capture the business. And an unregulated firm, even if monopolistic, will have sought the profit-maximizing price and output for each of its goods or services; thus a price increase on some lines, aimed at recouping losses on another, would only aggregate its loss.

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claim to succeed. In both *FPC v. Texaco Inc.*, 377 U.S. 33 (1964), and *United States v. Storer Broadcasting Co.*, 351 U.S. 192 (1956), the Court upheld the use of rulemaking to identify necessary (but not sufficient) criteria for licensure. Here the Commission has identified criteria that are conditionally sufficient for certification. We see no difference in principle, and indeed we upheld such a provision in *National Tour Brokers Ass'n v. ICC*, 671 F.2d 528 (D.C. Cir. 1982).

[35] *See* S. Rep. No. 948, 77th Cong., 2d Sess. 7 (1942); *see FPC v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 13 n.9 (1961).

The challenge before the Commission was to see whether it could accomplish the congressional intent of protecting ratepayers from such risk-shifting and at the same time allow natural gas customers to benefit from investment and competition freed from the deadening effects of the system of certification that had evolved over the years since 1938. Its OEC procedures are thus an experiment designed to realize the congressional scheme, not to defeat it.

The losses possibly to be suffered by existing firms, whose business the applicant may capture, are another matter. But the Commission's criteria also address that problem. Firms will apply only when their managements believe that they will be able to capture enough business to repay the investment. That estimate will be correct only under certain circumstances: there must either be undercapacity in the market (so that the applicant and incumbent firms can both enjoy an adequate return), or the incumbent firms must be performing so inefficiently that the applicant can underprice them, or the incumbent firm must be discriminating in price against the customer or class of customers that the new entrant seeks to serve. If undercapacity is the explanation, the investment entails no waste. If incumbent-firm inefficiency or price discrimination is the explanaton, then certification will result in losses for a firm that, so far as appears, deserves to lose. (We address below the special case of an incumbent firm that loses business because the state regulatory agency has *forced* it to engage in price discrimination.)

Thus certification under the OEC rules seems likely to occur only when the risk of wasteful investment is remote. Of course the applicant pipeline may err; all of us do. But the Commission has at least implicitly estimated that the risk of error by a pipeline management, with its company's solvency at stake, is no greater than the risk of error by the Commission itself. *See* J.A.

593-95. The Commission also anticipated that by lowering bureaucratic barriers to entry the rule would afford consumers the benefits of competitive (or at least more competitive) pricing. *See* J.A. 553, 561. As the Commission has given the applicant firms an incentive to make the decision correctly, we cannot gainsay its belief that the rule will in fact protect consumers from the adverse consequences of inefficient construction.

But where entry will inflict deserved losses on an incumbent LDC, some or all of those losses may ultimately fall not on its shareholders but on its remaining customers—most notably its captive residential consumers. Several petitioners strenuously argue that the Commission's presumption violates congressional purpose to the extent that it creates such a risk. *See* Brief of the American Gas Ass'n at 15-19; Brief of Associated Gas Distributors at 15-16; Brief of the State Commission Petitioners on Bypass Issues at 24ff.

The Commission argues that the risk is slight, that state regulatory agencies have the necessary authority to keep it slight or reduce it even further, and that those agencies can protect captive consumers in the instances where it does occur. We find the Commission responses persuasive.

First, FERC notes that the record contains little to suggest that industrial consumers want to bypass their distributors. *See* FERC Brief at 158 n.1. Indeed, it seems logical to suppose that what they want is gas at competitive prices. So long as the LDC will provide such gas—either as merchant or as transporter of gas bought at the wellhead or from a broker—the customer will have no incentive to try to induce pipeline investment in new facilities for a bypass. So long as the LDC is able to gain a return from the provision of transportation services, reduced purchases by the industrial buyer will normally have no more than a modest negative impact.

Second, state agencies have a variety of powers by which to control the risk of bypass. That risk seems to derive primarily—perhaps almost exclusively—from LDCs using industrial rates to subsidize residential consumers, perhaps under regulatory pressure from state commissions. The Commission so asserts, FERC Brief at 159 n.1, and the record provides at least implicit support. Several commentators asserted that pipelines would "skim the cream" from among a distributor's customers, J.A. 559. *See also* Brief of Associated Gas Distributors at 32 (alluding to the potentially contested industrial user as a "lucrative customer"). "Cream-skimming" necessarily involve cross-subsidization: a customer is "creamy" simply because the rate structure allows the firm to extract from it a disproportionate share of costs. *See, e.g.*, E. Gellhorn & R. Pierce Jr., *Regulated Industries* 275 (2d ed. 1987). Consequently, the Commission suggests, state agencies can head bypass off by adopting more strictly cost-based rate designs. *See* J.A. 1260.

State agencies may also control bypass by virtue of their jurisdiction over the bypassing transportation itself. The Supreme Court has upheld state power to require a pipeline to obtain from it a certificate of convenience and necessity before selling gas at retail (and bypassing an LDC), even where it recognized that the "end result" of the requirement might be "prohibition of particular direct sales." *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329, 336 (1951). The exact scope of this power is unplumbed, and is not before us now. But *Panhandle* clearly tends to undermine petitioners' assault on the Commission's refusal to except bypass situations from the OEC procedures, insofar as that assault turns on assumptions of total state incapacity to address the issue.

Similarly, the suggestion of our partially dissenting colleague that the OEC rule has "overridden the states' ability" to subsidize residential consumers by charging

higher rates to large industrial customers, *see post* at 3, is correct only in a very limited sense. For example, even if we disregard the residual authority left in place by *Panhandle*, a state is free to tax gas sales to industrial customers and apply the proceeds to whatever subsidies it likes. This may be more awkward than the present arrangement, in which a state commission may attune its rate rulings to the price elasticity of each purchasing firm. But to say that is only to say that the present arrangement allows states to employ extraordinarily ad hoc means to finance subsidy programs. *Panhandle* may well allow persistence in such practices. If it does not, it is hard to see anything in the NGA that guarantees states the right to use such means, especially where the constraining factor is a Commission rule adopted in fulfillment of its duty under the Natural Gas Act to assure that natural gas be sold "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest." *See Atlantic Rfg. Co. v. Public Service Comm'n*, 360 U.S. 378, 388 (1959).[36]

Third, in the event that bypass does occur despite the potential competitive responses of LDCs and state commissions, FERC argues that the commissions may protect the captive consumers by modifying rate designs so that LDC shareholders, rather than ratepayers, bear the consequences of LDC inability to handle competition. *See* J.A. 1260. Where the LDC can be shown to have lost the business through imprudent judgments, that authority seems indisputable. That may dispose of the lion's share of cases. The state commissions argue that under *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), they could not deny recovery of costs that were

[36] The quoted language, taken from the original version of NGA § 7(c), refers to prices for gas sold interstate for resale, but the purpose presumably also applies to the pricing of interstate gas transportation services.

prudently incurred. We do not think *Hope* so restrictive. If the investment was prudent when made, but the losses occurred because the LDC maintained an irrational rate design that drove away the industrial customers, it is hard to see anything in *Hope*'s modest constitutional requirements that would bar state commissions from curtailing return on investment thereby wasted. Of course the matter would be different if the state commission had forced the LDC to maintain the vulnerable rate structure.

We note in this connection that the Brief of Associated Gas Distributors contends both that the Commission has neglected its duty to protect consumers by "delegating" it to state commissions, Brief of Associated Gas Distributors at 15-16, and that it has intruded upon the regulatory jurisdiction of the states, *id.* at 33-35. The first arm of this paradoxical complaint seems to us to assume far too great a reach for FERC's obligations. The Natural Gas Act was adopted in order to fill a "regulatory gap" created by Supreme Court decisions finding the states without power, as a result of negative implications of the commerce clause, U.S. Const. Art. I, § 8, cl. 3, to regulate interstate sales at wholesale. *See* H. Rep. No. 709, 75th Cong., 1st Sess., 1-2 (1937) (citing *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924), and *Public Utilities Commission v. Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927)). The Commission fulfills its mission under the Act if it establishes conditions by which the gas arrives in the hands of consumers or LDCs on terms that conform to the Act. That consumers may later suffer because of regulatory decisions made by state commissions, acting pursuant to their lawful authority, evidences no "delegation" by FERC.

The claim of intrusion on state authority appears to derive from the view that FERC authorization of transportation under OEC will lead to transactions that sharply affect state interests but which the state is un-

likely to be able to control. The specific example offered is of gas purchased out of state by an industrial user and then transmitted through OEC facilities. Brief of Associated Gas Distributors at 35. The distributors argue that state regulation of such a sale may not be legal. They suggest that *Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission*, 341 U.S. 329 (1951), holding that the NGA left intact state authority to regulate direct *pipeline* sales to an industrial end user, might not encompass an end user's purchase of gas from an out-of-state supplier.

Thus the contention is that the OEC procedures may present a state with a dilemma. We remain uncertain why the possibility of this dilemma should be characterized as an intrusion into state authority. In any event, the entire problem turns upon application of *Panhandle* to a set of facts that is not before us. Accordingly, we find the claim too hypothetical for disposition in this context.

Finally, we note that the presumption created by the OEC procedures is rebuttable. We cannot know at this point precisely what will be necessary to persuade the Commission that application of the presumption is inappropriate. But the existence of that backstop confirms our judgment that the OEC rules themselves can readily be applied in a manner consistent with the congressional purposes.

The Associated Gas Distributors claim that the OEC rules constitute a breach of the Commission's procedural obligation to ferret out relevant information even when no party draws its attention to them. They cite *Scenic Hudson Preservation Conference v. FPC*, 354 F.2d 608, 619-22 (2d Cir. 1965), *cert. denied*, 384 U.S. 941 (1966), which faulted the Commission for failure to pursue a wide variety of issues that environmental intervenors had brought to its attention. The court said that the Commission had "an affirmative duty to inquire into and

consider all relevant facts." *Id.* at 620. This proposition seems unexceptionable but irrelevant. The Commission determined that in most instances compliance with the limited criteria would assure a properly certificable facility or service, and provided for intervention in individual cases where anyone thought otherwise. Further, the issues not directly addressed in the initial criteria—notably, impact on competitors—are precisely the ones that are likely to trigger intervention. Under these circumstances, the procedures seem likely to assure an adequate vetting of all relevant and persuasive contentions.[87]

2. *Unsupported assumptions.*

The state commissions argue strenuously that the Commission has made an unwarranted assumption that under its OEC rules the pipeline will bear all the risks of a venture. The commissions point to rules allowing the applicant to charge a reservation fee for firm transportation. *See* § 157.103(d)(3). Such a charge of course involves risk-sharing *with the particular customer* who arranges for the service. But that form of risk-sharing seems wholly compatible with the Commission's fundamental reasoning: no risk is shifted onto any natural gas consumer against its will.

Many LDCs argue that the Commission has wrongly assumed that LDCs have the capacity to compete with pipelines for industrial customers on an equal footing. They point specifically to the LDCs' being subject to

[87] ANR Pipeline Company and Colorado Interstate Gas Company object to 18 C.F.R. § 157.103(d)(4), which provides that a pipeline offering OEC service may never decrease the units projected for ratemaking purposes below those projected in the original filing. They say that this defies standard principles of ratemaking, under which projections are altered to fit changed circumstances in order to prevent unlawful impairment of the regulated firm's capital. At least where the service is initiated under special rules promulgated clearly in advance, and seeking to mimic market constraints on firm behavior, we see no illegality.

legal service obligations (including duties to continue service even to customers that fail to pay their bills) and to restrictions on selective discounts.

We find no basis for believing that the Commission acted on false premises. The existence of service obligations alone does not distingish LDCs from pipelines. Both are subject to them; the pipelines' are discussed in this opinion's section on CD modification. That some states may impose greater burdens on LDCs hardly seems a sufficient basis for the Commission to refrain from its efforts to stimulate the availability of a supply of gas at competitive prices. If states choose to require LDCs to continue service to non-paying customers, those states must address the consequences. They can extract the cost from price-inelastic customers, primarily the solvent residential consumers; they can seek to extract the cost from industrial customers, at the peril of driving them off the system; they can fund the expense out of tax revenue; they can use their power under *Panhandle* to thwart the possible bypass, accepting the economic consequence that their industrial gas users may be unable to compete with firms in other states. All of these choices may involve some pain—like all true choices. But that hardly requires the Commission to abandon its effort, required under the NGA, to facilitate the flow of competitively-priced gas into the hands of gas consumers everywhere.

3. *Alleged failures of reasoned decisionmaking.*

The state commissions fault the Commission for failing to explain the shift from a former policy against allowing bypass. Supporting its view of the existence of such a policy, the commissions cite three cases that may be so read. *See Panhandle Eastern Pipe Line Co.*, Opinion No. 539, 39 F.P.C. 581 (1968); *Panhandle Eastern Pipe Line Co.*, Opinion No. 274, 13 F.P.C. 301 (1954), *aff'd* 232 F.2d 467 (3d Cir. 1956), *cert. den.*, 352 U.S.

891 (1956); *Southern Natural Gas Co.*, 25 F.P.C. 925 (1961). While it is true that the Commission has not, so far as we can discover, explicitly addressed the fact of this policy change, its overall reasoning provides ample explanation for modifying the policy.

The only ground ever given by the Commission for any prior anti-bypass policy—so far as we are able to determine—was its concern over the wasteful construction of duplicative facilities. *See Southern Natural Gas Co.*, 25 F.P.C. 925, 927 (1961). In the absence of a mechanism for preventing such waste, the policy is quite understandable. In its deliberations leading to Order No. 436, however, the Commission believed it had discovered a mechanism for solving that problem, namely, its risk-to-applicant rules. As we believe the Commission adequately justified its view that this form of certification would prevent the waste that the NGA's certification procedure sought to avoid, the Commission was not obliged to supplement the discussion by express consideration of the demise of its former policy.

VII. Miscellaneous Arguments

In addition to the broad attacks on Order No. 436 discussed above, the parties raise a number of relatively minor concerns.[38]

A. *Pipeline Sales Service Issues.*

A number of parties assert that FERC acted unlawfully in promulgating Order No. 436 without addressing various problems presented by pipeline sales service. The challenged omissions include: failure to completely bar minimum commodity bills (Brief of Columbia Gas Transmission Corp.); refusal to extend Order No. 436 to the transportation component of sales service (Brief of Peo-

[38] Those challenges not discussed in the opinion appear to us duplicative of others or frivolous and are dismissed.

ples Gas Light & Coke Co. and North Shore Gas Co.); failure to eliminate sole supplier provisions from pipeline sales tariffs (Brief of Central Illinois Light Co.).

As the Notice of Proposed Rulemaking made clear from the start, however, FERC intended Order No. 436 to be a comprehensive resolution only of transportation issues. In order to accomplish its goal of uncoupling transportation services from sales service effectively and in conformity with this court's holdings in the *MPC* cases, FERC addressed certain issues presented by sales service, notably CD conversion/reduction and the producer-pipeline purchase contracts. As we noted above, consideration of these issues was in all likelihood essential to FERC's task. Whenever possible, however, FERC has left sales issues for resolution outside of Order No. 436. This necessarily causes a certain incompleteness. But all natural gas issues are related to each other. That the web is seamless does not require an agency to reweave the whole whenever it reweaves a part. An agency is entitled to the highest deference in deciding priorities among issues, including the sequence and grouping in which it tackles them. *Cf. Heckler v. Chaney*, 470 U.S. 821, 831-32 (1985). We see no abuse of discretion in FERC's decisions to exclude the specified items from this page of its agenda.

B. *Notice Provisions.*

The Industrial End User Group objects to the notice and protest provisions applicable to § 7 transportation, 18 C.F.R. § 284.223, contrasting them with the far less onerous reporting requirements applicable to § 311 transportation, 18 C.F.R. §§ 284.106, 284.126. The Group argues that the discrepancy constitutes an unjustifiable discrimination, thus violating the Commission's statutory mandate and its stated purposes in embarking on the rulemaking. The distinction has bite for the industrial users because they are ineligible as direct beneficiaries

of § 311 transportation, which must be on behalf of an LDC or another pipeline.

We agree with FERC that there is both factual and legal support for the distinction. As FERC notes, petitioners' main objection is that such provisions make it more difficult to effect a bypass of an LDC, a situation FERC regards as meriting special scrutiny. The industrial users suggest that even on that basis no special notice is needed, for, they say, the gas will be transported either (1) to an existing direct customer or through an LDC, in which case no injury occurs, or (2) through a new connection, the construction of which would require Commission approval under § 7. But we do not understand these to encompass the universe of possible cases. An industrial user now supplied in part by a pipeline and in part by an LDC, for example, might shift away from reliance on the LDC and towards gas carried under a § 7 blanket certificate.

Moreover, the Commission in the rulemaking called attention to the value of fulfilling § 311's purpose of integrating the formerly segregated interstate and intrastate markets. J.A. 1225-26. Though articulated in a different context, the point supports less stringent rules for § 311 transportation. In § 311 Congress gave FERC broad authority to prescribe terms of transportation thereunder; it surely did not contemplate that FERC would use this authority to duplicate the regulatory scheme in place under the NGA, including its elaborate certification mechanism. *See* NGPA § 601(a)(2), 15 U.S.C. § 3431(a)(2) (1982) (Commission's NGA jurisdiction not to apply to transportation provided under § 311). The distinction drawn by the Commission is completely congruent with the one drawn by Congress in the two statutes.

C. *Transportation Policies.*

The Industrial End User Group also argues that FERC acted unreasonably in refusing to require pipelines not

electing to operate under Order No. 436 to publish their transportation policies in their tariffs. This issue is currently pending in an individual rate case now on review before the Commission from an administrative law judge's initial decision, *Transcontinental Gas Pipe Line Corp.*, 33 F.E.R.C. ¶ 63,035 (1985). The Group has not met the heavy burden of establishing the inadequacy of resolution in that forum. *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294-95 (1974).

D. *Construction of Facilities for Use in § 311 Transportation.*

Maryland People's Counsel asserts that Order No. 436 violates the NGA by leaving in place a prior regulation making clear that construction of facilities for use solely in providing § 311 transportation does not require § 7 certification. *See* 18 C.F.R. § 284.3(c) ("The [NGA] shall not apply to facilities utilized solely for transportation authorized by section 311(a) . . . ."). The crux of MPC's argument is that Order No. 436 expands § 311 transportation to the point where it is indistinguishable from § 7 transportation. Relying on legislative history indicating that Congress adopted § 7 in order to assure that consumers were protected from having to bear the costs of uneconomic construction, MPC contends that FERC must, in effect, extend the construction certification requirements of § 7 to § 311.

MPC's claim turns on the premise that Order No. 436 makes § 311 transportation a clone of transportation under § 7. We find this exaggerated. As Congress specified, § 311 transportation is limited to transportation on behalf of an LDC or a pipeline. Other petitioners call our attention to instances where that requirement appears to be fulfilled more in name than reality.[39] We

[39] The only elaboration the rule provides on the exact nexus required to satisfy the "on behalf of" standard is a statement that physical receipt is not necessary, but that the gas must be transported "for [the] account" of the benefited entity. J.A. 504-05 (reaffirming Order No. 46, 44 Fed. Reg. 52,179, 52,180 (1979)).

are told that in one case the contact with an LDC consists only of transportation through a six-foot stretch of pipe. Brief of Southern Indiana Gas & Elec. Co. at 13. Despite this episode, we do not believe that petitioners have shown a sufficient identity between § 311 and § 7 transportation to call FERC's judgment into question.[40] First, we are shown no evidence that § 311 transportation frequently—much less uniformly—pivots on a merely nominal connection with an LDC or other pipeline. Second, § 7(h) gives the holder of a § 7 certificate a power of eminent domain to acquire right-of-way to implement the Commission-approved plan; no such power accompanies authorization under § 311.

Thus, MPC would have us order the Commission to graft regulatory burdens mentioned only in the NGA onto § 311 merely because transportation under the two sections overlaps to some degree. This Congress did not intend; in the NGPA it declined to require a system of certification akin to that of § 7. Congress clearly recognized that consumer protection purposes can be achieved without control over entry. It selected for § 311 transportation a system paralleling its choice for oil pipeline: control over price but not entry. *See* NGPA § 311(a)(1)(B), 15 U.S.C. § 3371(a)(1)(B) (1982) (providing power over rates for service); 42 U.S.C. § 7172(b) (1982) (transferring to FERC regulatory power to establish rates and charges of oil pipelines). Congress underscored this distinction in NGPA § 601(a)(2), providing that transportation in interstate commerce under § 311 shall not trigger the Commission's NGA jurisdiction. This seems an unequivocal expression of intent that NGPA regulation should not replicate the burdens of the NGA.

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[40] In this connection we note that it is the practical effect of the "on behalf of" distinction that prompts the Industrial End User Group's objection to the more exacting notice provisions applicable to § 7 transportation.

E. *Grandfathering Decisions.*

In Order No. 436 FERC grandfathered a number of existing transportation arrangements for varying periods of time. These are attacked as too short or too long, or as being unjustified in comparison to the treatment of other arrangements.

All grandfathering decisions necessarily involve a trade-off between the values of stability on one side and of promptly securing a new rule's benefits on the other. FERC undoubtedly has power to make such adjustments; no petitioner questions it. Although FERC must exercise the power in a reasoned manner, such exercises are "necessarily arbitrary to some extent." *Capital Cities Communications, Inc. v. FCC*, 554 F.2d 1135, 1139 (D.C. Cir. 1976).

Michigan Consolidated Gas Co. ("MichCon") complains that the Commission's decision to grandfather blanket certificates previously authorized under § 311 and § 7 is an unreasoned one. It attacks both the decision to grandfather these transactions at all and the duration of the exemptions, which in the case of some § 7 certificates can run as long as 10 years from their start (the latest of which presumably originated shorty before promulgation of Order No. 436). Most acutely, MichCon argues that termination of these arrangements will not interrupt anyone's supply of gas. As the pipelines are more than able to satisfy any displaced sales from their supplies, the functional effect is merely to provide the presently-favored parties continued access to low-priced gas and to increase the probability that others will not secure such access. (The grandfathered authorizations tend to relax the pressure on pipelines to accept Order No. 436.) FERC conceded as much in rejecting the high-priority users' pleas for a permanent exemption. J.A. 506-07 ("there is no need to retain special procedures for a limited group of shippers"). So far as appears, however, FERC grandfathered these transactions with no

more than references to the desirability of a smooth transition to a new order, J.A. 273, to the reliance the parties placed on this transportation, J.A. 491-95, and to the authorized duration of the transactions and the need to avoid undue infringement on them, J.A. 1183.

These phrases do not seem to us to meet the modest standard implicit in the concept of reasoned decisionmaking. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co.*, 463 U.S. 29, 42-43 (1983). Thanks to the delays of the legal process (for which we acknowledge our share of responsibility), the grandfathering that expires October 9, ~~1987~~ is nearly moot and scarcely worth mentioning. Matters are different for transactions whose unlawfulness is extended into the mid-1990s. Perhaps there are rare enough, or involve so little volume, that the grandfathering will only trivially encourage pipeline resistance to the concept of nondiscrimination. Or perhaps the equities of the participants are stronger than appear. We cannot, however, "discern the path" by which the Commission has reconciled such grandfathering to its acknowledged mandate to stamp out discrimination. *Cf. Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285-86 (1974).

The intrastate pipelines attack from the other side, challenging FERC's failure to preserve all preexisting § 311 authorizations for their full authorized terms. Order No. 436 permits previously authorized § 311 transactions to continue until the earlier of their expiration or two years after the Order's effective date. The two-year grandfather period allows previously authorized § 311 transactions to come to a natural end, as FERC generally limited such transactions to two-year terms. 18 C.F.R. § 284.102(b)(1)(i) (pre-Order No. 436 version). In some instances, however, FERC provided for longer terms, *see id.* § 284.102(b)(2); the two-year grandfathering limit will cut some of these short. The petitioners contrast this with FERC's decision to grandfather existing § 7 certificates for their full terms.

There are two elements to the intrastate pipelines' attack on FERC's distinction between § 311 and § 7 grandfathering. First, they implicitly attack the existence of any line between the two at all, and here we cannot agree. In imposing the two-year ceiling on these § 311 extensions, FERC relied on its regulation, adopted at the outset of § 311 authorization, expressly making such certificates subject to prospective change. *See* Order No. 46, 44 Fed. Reg. 52,179, 52,181-82 (1979) (codified in pertinent part at 18 C.F.R. § 284.5); J.A. 1180-81. In its brief (though not in the rulemaking itself) the Commission contrasts that explicit warning with its absence in the § 7 context, suggesting greater likelihood of justifiable reliance in the latter. We think the point strong enough to explain non-identical treatment.

Insofar as the intrastate pipelines challenge the size of the discrepancy in treatment, we must agree. Above we found inadequate FERC's explanation for allowing the continuation of § 7 transportation for five- and ten-year terms. The discrepancy in treatment of § 311 authorizations deepens our mystification.

We can find no merit in petitioner Tenneco's lament that the Commission did nothing to allow continuation of the sales underlying the SMPs invalidated in *Maryland People's Counsel v. FERC*, 761 F.2d 768 (D.C. Cir. 1985) (*"MPC I"*). The entire thesis of *MPC I* was that the Commission had failed to assure that transportation for those purposes did not unduly discriminate. Order No. 436 is the Commission's answer. It allows those sales to continue, so long as the transportation is provided on a nondiscriminatory basis. We can detect no reason why the Commission should even consider finding an especially soft berth for the SMP gas. Such a view would nullify this court's time limit on continuation of the SMPs. *See Maryland People's Counsel v. FERC*, 768 F.2d 450, 455 (D.C. Cir. 1985) (*"MPC III"*).

F. *System Supply Limitation.*

Prior to Order No. 436 a FERC regulation limited § 311 transportation to gas delivered to an LDC, an intrastate pipeline, or an interstate pipeline for "its 'system supply for resale.'" J.A. 504 (referring to 18 C.F.R. 284.102(b)). As part of Order No. 436 FERC amended this regulation to permit transportation under § 311 in any case where it is "on behalf of" an intrastate pipeline or LDC, J.A. 505, thus incorporating the standards of the statute itself, NGPA § 311(a)(1)(A), 15 U.S.C. § 3371(a)(1)(A) (1982). Southern Indiana Gas and Electric Company contends that this change impermissibly opens "the way for interstate pipelines to invade the core markets of LDCs without prior FERC approval or the approval of the state regulatory commission." Brief of Southern Indiana at 12.[41] As noted above, it points to a case where the LDC on whose behalf the gas is transported itself carries the gas for only six feet. *Id.* at 13. Southern Indiana argues that elimination of the test is a "perversion" of § 311 because it will enable pipelines to bypass an LDC.

We disagree with Southern Indiana's contention that § 311 was "expressly intended to benefit LDCs." *Id.* The purpose of § 311—so far as we are able to discern—is not to bestow special benefits on any of the parties on

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[41] Laclede Gas Co. also attacks the elimination of the system supply requirement. The attack rests in part on the ground that this action will undermine the incremental pricing provisions of the NGPA, which we reject for the reasons given *infra* part VII.G. It further rests on an asserted negative inference from the Public Utilities Regulatory Policies Act, Pub. L. No. 95-617, § 608, 92 Stat. 3117 (1978), which was adopted the same day as the NGPA and amended § 7(c) to authorize the Commission to use a rulemaking to permit transportation for high-priority end users. That Congress especially authorized such an approach for high-priority users may reflect no more than that it thought of them as the most likely recipients of unbundled transportation; the case for applying *expressio unius est exclusio alterius* seems weak in this context.

whose behalf it authorizes transportation (*i.e.*, interstate pipelines and intrastate pipelines as well as LDCs), but to reduce the barriers between the interstate and intrastate gas markets. *See Public Service Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 342 (1983); *Process Gas Consumers Group v. United States Dep't of Agric.*, 694 F.2d 728, 764 (D.C. Cir. 1981) (other portions vacated and reconsidered *en banc*, 694 F.2d 778 (D.C. Cir. 1982)), *cert. denied*, 461 U.S. 905 (1983). The many comments received on this issue, including those of LDCs, indicate that the system-supply test frustrated this purpose by placing LDCs at a severe disadvantage as against pipelines serving industrial end users directly under § 7 certificates. J.A. 504 & n.119. The Commission's decision to eliminate the test in favor of a rule more closely tracking the language of the statute—and thereby rendering the legal barrier far more permeable—was well within its powers.

G. *Transportation for Fuel-Switchable End Users.*

Laclede Gas Company contends that by adopting a program that permits fuel-switchable end users access to self-implementing transportation, FERC has impermissibly undermined the incremental pricing provisions of Title II of the NGPA, 15 U.S.C. §§ 3341-48 (1982). We reject the claim.

Congress sought to achieve two purposes in providing for incremental pricing. The first was to protect high-priority end users from a portion of NGPA-permitted price increases by shifting those costs to industrial users. *See Ohio Ass'n of Community Action Agencies v. FERC*, 654 F.2d 811, 813 (D.C. Cir. 1981). The second—the "market-ordering" purpose—was to maximize pipelines' incentive to bargain with producers. Congress recognized that the system of pricing tiers (low ceilings for old gas, higher ceilings for new and none for certain high-cost gas) could lead pipelines to bid more for new

or high-cost gas than their estimates of the long run market-clearing price. (Simplifying, pipelines would use the savings on old gas to finance purchases of new or high-cost gas; though paying supra-market prices for the latter, it would be able to recover the cost by selling at average prices. *See* National Regulatory Research Institute, *State Regulatory Options for Dealing with Natural Gas Wellhead Price Deregulation* 40-51 (1983). *But see* Niskanen, *Natural Gas Price Controls: An Alternative View*, Regulation 46 (Nov./Dec. 1987).) Incremental pricing would supposedly cure this by forcing the pipelines to bid no more for high-cost or new gas than the price-elastic segment of the market would bear. *See, e.g.*, Rule Required Under Section 202 of the Natural Gas Policy Act; Incremental Pricing, 45 Fed. Reg. 31,622, 31,623 (1980); Natural Gas Policy Act; Incremental Pricing; Phase II, 48 Fed. Reg. 55,294, 55,295-96 (1983). The principle has largely collapsed. Falling oil prices have made it impossible to load any significant portion of NGPA-permitted increases onto fuel-switchable consumers. 48 Fed. Reg. at 55,296.[42]

Laclede's thesis is that elimination of the system supply test will facilitate industrial end users' efforts to purchase gas directly from producers rather than through pipelines or LDCs. This, it suggests, will evade the intent of Congress in establishing incremental pricing, as incremental pricing only operates on pricing by pipelines and LDCs, not on direct producer sales to end users.

Laclede's theory extrapolates far too much from the incremental pricing provisions. If accepted, it would seem

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[42] For December 1986, alternative fuel price ceilings ranged from a low of $1.23 in Washington to a high of $1.95 in Minnesota, Nebraska, North Dakota and South Dakota. *Alternative Fuel Price Ceilings by States, by Month*, Natural Gas Monthly 64 (Jan. 1987). For the same period, the pipelines' average cost for gas produced from producers was $2.16. *Selected National Average Natural Gas Prices*, Natural Gas Monthly 10 (Jan. 1987). Thus it appears impossible for the pipelines to apply a surcharge in today's market.

to require invalidation of all blanket-certificate transportation for users possibly subject to incremental pricing, perhaps even case-specific certification. Further, Order No. 436 constitutes in itself an alternative mechanism for achieving the purposes of incremental pricing. First, it will give LDCs direct access to wellhead market prices considerably lower than pipelines' embedded contract gas costs. *See supra* part I. Second, by affording all parties access to a competitive wellhead market it prevents pipelines from passing through—and therefore from bidding—prices exceeding their estimates of the long run market-clearing price. Where the Commission has devised methods for effecting Congress's goals in Title II of the NGPA, it would be extraordinary for a court to spin out a remote inference from those provisions to strike down a portion of its handiwork.

Moreover, Congress was deeply concerned lest incremental pricing cause fuel-switchable end users to bolt the system, exposing high-priority customers to higher prices as a result of load loss. *See Ohio Ass'n of Community Action Agencies v. FERC*, 654 F.2d at 821-22. Order No. 436 in general, and elimination of the system supply test in particular, respond to that interest. By promoting fuel-switchable end users' use of pipeline transportation service, they make it possible for captive customers to bear a smaller portion of the pipelines' fixed costs.

VIII. Conclusion

As a general matter we uphold the substance of Order No. 436 and the procedures the Commission employed in adopting it. However, we have found problems in a few of the Order's components and must remand the matter to FERC for further proceedings. We now summarize these defects briefly.

The CD adjustment conditions suffer from a want of both legal authority and reasoned decisionmaking. The problem with legal authority stems from the Commis-

sion's misplaced reliance on § 7(e); the lack of reasoned decisionmaking lies in its failure to trace the path that led it from the statutory authority and the facts to its adoption of the CD reduction option. On remand, FERC is free to attempt to remedy these problems. If, however, it elects to go forward with the Order without CD conversion, it must, of course, explain why it feels that such a condition is no longer necessary.

The Commission's decision not to take any affirmative action to solve the problems posed by the uneconomic producer-pipeline contracts also fails to meet the standards of reasoned decisionmaking. On remand, FERC must more convincingly address the magnitude of the problem and the adverse consequences likely to result from the nondiscriminatory excess and CD adjustment conditions. It is not our place to say whether FERC should take measures to shift these losses from where they now lie; we ask only that it explain its course.

Finally, FERC has failed to adequately explain some of its grandfathering decisions. Even though a certain amount of arbitrariness goes with this territory, the Commission must reveal a reasoned basis for its decisions.

The parts of Order No. 436 are interdependent. The nondiscriminatory access and CD adjustment provisions aggregate the pipelines' jeopardy from take-or-pay liability. When coupled with take-or-pay liability, those provisions may bring about a wasteful imbalance between pipeline sales and unbundled transportation service. Thus the Commission's apparent insouciance on take-or-pay taints the package. And CD adjustment, which the Commission has identified as essential to remedying problems deriving from the pipelines' market power, suffers from independent vulnerabilities. Accordingly, we vacate Order No. 436 and remand for further proceedings consistent with this opinion.

It is so ordered.

MIKVA, *Circuit Judge, concurring in the judgment in part and dissenting in part*: I join in most of the majority's conclusion about this massive and historic order. Unfortunately, even in the many instances in which I share the majority's judgments, I remain wary of endorsing the totality of its exposition and analysis, and therefore I concur in the results only. Certainly a case of this scope requires a judicial response of some length and care, and I commend the majority's devotion to that task. But the majority's exhaustive, scholarly investigation of the history, regulation, and inner workings of the natural gas industry is, I believe, dangerously overbroad. I am concerned that tucked within the opinion's labyrinthine treatment of the issues are loose language and stray observations that could be viewed to stand for the position of this court on a range of matters only peripherally before us in this case but that may be squarely presented in the future. I believe we would have better served these and future parties with a more concise exposition of the basis for each of our holdings today. In addition, I part company with the majority on the issue of the "optional expedited certificates," which I believe improperly impinge on the power of state commissions to ensure affordable rates for individual consumers.

Before detailing my one point of discord with the majority's conclusions, I summarize the points of agreement. I fully agree that the Commission has statutory authority under the NGA and the NGPA to impose the open-access requirements. I also agree that as currently written, the so-called "first-come, first-served" condition is far too inchoate to bind industry members; before the Commission can seek to enforce this condition, it must elaborate how it works in practice, and that explanation must pass judicial review. I also share the majority's view that there is no legal defect in the rate provisions of Order No. 436. And I agree with the court's disposition of the contract demand adjustment provisions: the

Commission chose to rely on faulty authority for implementing the CD conversion, and it failed to provide independent grounds for the CD reduction provision. On remand, FERC can attempt to correct both these inadequacies.

I share the majority's appraisal of the Commission's treatment of the take-or-pay issue. The Commission's decision to take no affirmative action to ease take-or-pay liabilities is especially questionable in view of the fact that Order No. 436 actually exacerbates the already acute problem in at least two ways. First, the nondiscriminatory access condition significantly weakens the pipelines' bargaining position vis-à-vis producers; it is fanciful to imagine that producers will agree to meaningful reforms in their take-or-pay contracts when they know that the pipelines must transport their gas in any event. Second, the CD adjustment provisions prevent the pipelines from enforcing contracts that would pass along at least some of the high costs of take-or-pay contracts to the local distribution companies (LDCs). Thus, the pipelines effectively get squeezed from both ends. The Commission's insouciance in the face of these circumstances, many of which it helped bring about, is inappropriate. On remand, the Commission has a number of options before it, but I believe these should not include doing nothing whatsoever to assuage the take-or-pay situation. To the extent the majority invites the Commission to opt again for inaction but simply employ different reasoning, I dissent from the suggestion. How best to apportion these spiraling take-or-pay liabilities among the different players in the industry is admittedly a delicate problem. But the Commission's decision to close its eyes and hope the problem will go away is no solution and should not be tolerated on remand.

Finally, I believe the majority's treatment of the optional expedited certification procedures unduly vitiates the ability of state commissions to provide for affordable

energy for their residents. These procedures will make it far easier for pipelines to "bypass" LDCs—the local utilities with whom most consumers deal directly—and sell gas directly to large industrial end users. As the majority points out, *maj. op.* at 106, the chief reason that LDCs are vulnerable to bypass is that they frequently are required to subsidize residential consumers by charging higher rates to these large industrial end users. State commissions impose such two-tiered rate structures in order to protect local consumers, many of whom otherwise would be hard-pressed to afford their most basic energy needs. This practice has a long existence in the public utility field, and there is nothing in federal law that prohibits it. By facilitating efforts to bypass LDCs, the Commission effectively has overriden the states' ability to make such policy choices. Industrial end users will now be able to leave the system and get cheaper gas from the bypassing pipeline, leaving captive residential consumers to pay a greater proportion of the LDC's fixed costs. Thus, with no express invocation of federal preemptive power, the Commission has prevented the state commissions from protecting affordable rates for local consumers, which is a quintessential example of a matter of essentially local concern that should be regulated locally. *See Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm'n*, 341 U.S. 329, 333 (1951). This is why the state commissions were virtually uniform in urging the Commission to reconsider and in asking us to set aside this portion of Order No. 436. I believe the Commission, and now this court, too quickly dismissed these important concerns about intrusion into the states' sphere of authority and too casually disregarded the needs of the everyday consumer, whose energy bill is likely to increase dramatically as a result of this ill-considered provision. I believe also that the majority fails utterly to hold the Commission to its legal requirement of providing a reasoned explanation for its departure from its previous policy against bypass. *See*

Panhandle Eastern Pipe Line Co., Opinion No. 539, 39 F.P.C. 581 (1968). For these reasons, I dissent from that part of the court's opinion approving of the optional expedited certification provisions of Order No. 436.

(4) (3) (3) (3)

Nos. 87-976, 87-977, 87-979 and 87-1091

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

CITY OF WILLCOX, ARIZONA AND
ARIZONA ELECTRIC POWER COOPERATIVE, INC.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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STATEMENT REQUIRED BY RULE 28.1

All of the Respondents joining in this Brief, with the exception of Pennzoil Company and Chevron U.S.A., Inc., joined in the Petition for Certiorari filed in *Shell Offshore Inc., et al. v. Associated Gas Distributors, et al.*, No. 87-978, which sought a writ from *Associated Gas Distribution v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), the same decision which Petitioners in the captioned cases seek to have reviewed by this Court. In Appendix E to that Petition, these parties submitted a statement as required by Rule 28.1. The following statement is submitted on behalf of Chevron U.S.A., Inc. and Pennzoil Company:

CHEVRON U.S.A., INC.

Chevron U.S.A., Inc. is a wholly-owned subsidiary of Chevron Corporation. The non-wholly-owned subsidiaries and affiliates of Chevron Corporation are:

AMAX Inc.
Arabian American Oil Company
Atlas Supply Company
C-W Properties Inc.
Caltex Mediterranean Limited
Caltex Petroleum Corporation
Canyon Reef Carriers, Inc.
Chevron Capital N.V.
Chevron Capital U.S.A. Inc.
Chevron Investment Management Company
Chevron Oil Finance Company
Dixie Pipeline Company
Explorer Pipeline Company
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Glenwood Properties
Gulf Oil Finance Company
Kenai Pipe Line Company
Long Beach Oil Development Company
Mid-Valley Pipeline Company

Paloma Pipe Line Company
Pembroke Capital Company, Inc.
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PENNZOIL COMPANY

The non-wholly-owned subsidiaries and affiliates of Pennzoil Company are:

National Transit Company
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The Eureka Pipe Line Company
American Sulphur Export Corporation
Pennzoil (U.K.) Limited
P. T. Sungai Kencana
P. T. Indo Muro Kencana
Proven Properties Inc.

TABLE OF CONTENTS

	Page
STATEMENT REQUIRED BY RULE 28.1	i
TABLE OF AUTHORITIES	v
REASONS WHY THE WRITS SHOULD NOT BE GRANTED	2
I. The Commission's Orders Below Do Not Impose "Common Carrier Status" Upon Interstate Pipeline Companies	2
A. The Commission Has The Power And Duty Under The Natural Gas Act To Prevent "Undue Discrimination."	2
B. The Decision Below Creates No Conflicts Between The Circuits Or With Decisions Of This Court Requiring The Granting Of Certiorari	3
C. *FCC v. Midwest Video Corp.* And The Other Television Cases Are Not In Point	6
D. The Orders Below Do Not Force Interstate Pipelines To Become Common Carriers	9
1. Pipeline Participation In The Order No. 436 Program Is Voluntary	9
2. Non-Discrimination Is Not Common Carriage	11
E. Order No. 436 Does Not Violate Section 602(b)(2) Of The NGPA	12
II. The Optional Expedited Certificate Procedure Established By The Commission's Orders Represents A Valid Exercise Of The Commission's Authority And Contains Provisions Which Are Not Ripe For Review	14

TABLE OF CONTENTS—Continued

Page

A. The Optional Expedited Certificate Procedure's Substantive Provisions Are Within The Commission's Discretionary Authority And Will Not Interfere With State Jurisdiction 14

B. The Optional Expedited Certificate Procedural Provisions Are Not Ripe For Review.. 16

CONCLUSION 17

TABLE OF AUTHORITIES

CASES: Page

Abbott Laboratories v. Gardner, 387 U.S. 136 (1967) 17
Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378 (1959) 9
Burlington Truck Lines, Inc. v. United States, 371 U.S. 156 (1962) 15
Central Iowa Power Coop. v. FERC, 606 F.2d 1156 (D.C. Cir. 1979) 6, 8
Central Power & Light Co. v. FERC, 575 F.2d 937 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 981 (1978) 8
Columbia Broadcasting System, Inc. v. Democratic National Committee, 412 U.S. 94 (1973) 7
FCC v. Midwest Video Corp., 440 U.S. 689 (1979) 6, 7, 12
FCC v. Pottsville Broadcasting Co., 309 U.S. 134 (1940) 6
FPC v. Conway Corp., 426 U.S. 271 (1976) 5
FPC v. East Ohio Gas Co., 338 U.S. 464 (1950) 16
FPC v. Texaco Inc., 377 U.S. 33 (1984) 2
FPC v. Transcontinental Gas Pipe Corp., 365 U.S. 1 (1961) 2
Florida Power & Light Co. v. FERC, 660 F.2d 668 (5th Cir. 1981), *cert. denied*, 459 U.S. 1156 (1983) 3, 5, 6
Gulf States Utilities Co. v. FPC, 411 U.S. 747 (1973) 5, 8
Market Street Railway v. Railroad Comm'n, 324 U.S. 548 (1945) 10
Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) 8, 9, 11
Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985) 5, 8, 9, 11
Maryland People's Counsel v. FERC., 768 F.2d 450 (D.C. Cir. 1985) 8, 9, 11
Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983) 15

TABLE OF AUTHORITIES—Continued

	Page
National Ass'n of Regulatory Utilities Comm'n v. FCC, 525 F.2d 630 (D.C. Cir. 1976), *cert. denied*, 425 U.S. 992 (1976)	12
National Ass'n of Regulatory Utilities Comm'n v. FCC, 533 F.2d 601 (D.C. Cir. 1976)	12
Natural Gas Pipeline Company of America v. FERC, 765 F.2d 1155 (D.C. Cir. 1985)	5-6
New York State Electric & Gas Corp. v. FERC, 638 F.2d 388 (2nd Cir. 1980), *cert. denied*, 454 U.S. 821 (1981)	3, 5, 6
Otter Tail Power Co. v. United States, 410 U.S. 366 (1973)	3, 4
Panhandle Eastern Pipe Line Co. v. FPC, 232 F.2d 467 (3rd Cir. 1956), *cert. denied*, 352 U.S. 891 (1956)	3
Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951)	16
Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana, 332 U.S. 507 (1947)	16
Public Service Commission of New York v. Mid-Louisiana Gas Co., 463 U.S. 319 (1983)	8
Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969)	7
Richmond Power & Light v. FERC, 574 F.2d 610 (D.C. Cir. 1978)	3, 6
Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409 (1986)	8
United States v. Midwest Video Corp., 406 U.S. 649 (1972)	7
United States v. Southwestern Cable Co., 392 U.S. 157 (1968)	6, 7

TABLE OF AUTHORITIES—Continued

STATUTES AND REGULATIONS:	Page
Federal Communications Act	
47 U.S.C. § 153(h)	7
Federal Power Act, 16 U.S.C. § 791a, *et seq.*	4, 5
16 U.S.C. § 824e	5
16 U.S.C. § 824j	5
16 U.S.C. § 824k	5
Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.*	2, 3, 6, 15
§ 15 U.S.C. 717 c	2
§ 15 U.S.C. 717d	2
§ 15 U.S.C. § 717f	2, 10, 15
Natural Gas Policy Act of 1978, 15 U.S.C. § 3301, *et seq.*	2, 7, 8
15 U.S.C. § 3371(c) (1982)	2
15 U.S.C. § 3432(b) (1982)	12-13
Public Utility Regulatory Policies Act of 1978, P.L. 95-617, 92 Stat. 3117, § 203, *codified as* 16 U.S.C. §§ 824j & 824k	5
LEGISLATIVE AUTHORITIES:	
H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937)	16
H. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. (1978)	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-976

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 87-977

TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 87-979

CITY OF WILLCOX, ARIZONA AND
ARIZONA ELECTRIC POWER COOPERATIVE, INC.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

No. 87-1091

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

REASONS WHY THE WRITS SHOULD NOT BE GRANTED

I. The Commission's Orders Below Do Not Impose "Common Carrier Status" Upon Interstate Pipeline Companies.

A. The Commission Has The Power And Duty Under The Natural Gas Act To Prevent "Undue Discrimination."

It is quite clear from Order Nos. 436 and 436-A that the Federal Energy Regulatory Commission ("Commission") did not set out to impose common carrier status upon interstate pipeline companies, and affirmatively found that it had *not* done so.[1] Instead, the Commission established a format for transportation authorizations using its conditioning power contained in Section 7(e) of the Natural Gas Act ("NGA")[2] and Section 311(c) of the Natural Gas Policy Act of 1978 ("NGPA")[3] for issuing certificates of public convenience and necessity to interstate pipelines, thus carrying out the duties imposed upon it by Sections 4(b) and 5(a) of the NGA[4] to prevent undue discrimination by such pipelines. The Commission also required intrastate pipelines which transport gas under Section 311 of the NGPA to do so with-

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[1] J.A. 346-364, 1079-1086; Supplemental Appendix ("Supp. App.") [attached to this Brief] at SA-5 to SA-20, SA-21 to SA-27.

[2] 15 U.S.C. § 717f(e).

[3] 15 U.S.C. § 3371(c) (1982). *See also* H. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. 7 (1978).

[4] 15 U.S.C. § 717c(b); 15 U.S.C. § 717d(a). *See* INGAA App. 34a ("INGAA App." refers to the appendix submitted with the petitions in Nos. 87-976, 87-977, and 87-979). This Court has broadly construed the Commission's conditioning power under Section 7(c), FPC v. Texaco Inc., 377 U.S. 33 (1964), even where the Commission's only jurisdiction is over transportation by interstate pipelines, FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1, 25-30 (1961); Panhandle Eastern Pipe Line Co. v. FPC, 232 F.2d 467, 471 (3rd Cir. 1956), *cert. denied*, 352 U.S. 891 (1956).

out discrimination. The Commission found: (i) that pipelines possess substantial market power;[5] (ii) that they have exercised that power to deny their own sales customers, and others without fuel-switching capability access to competitively-priced gas;[6] and (iii) that this practice had denied consumers access to gas at the lowest reasonable rates.[7] These actions, the court of appeals found, constituted "extreme factual circumstances" showing discrimination, and that the effect of this discrimination was to deny gas users, and the economy generally, the benefits of a competitive wellhead market.[8]

B. The Decision Below Creates No Conflicts Between The Circuits Or With Decisions Of This Court Requiring The Granting Of Certiorari.

Petitioners[9] assert that the decision below creates a conflict between the circuits and is contrary to this Court's decision in *Otter Tail Power Co. v. United States*,[10] because it mandates the equivalent of "wheeling" for natural gas. In *Otter Tail* and several decisions of the courts of appeals,[11] it was held that the Commission lacked the authority to order such "wheeling" of electricity. The Petitioners assert that the decision below is inconsistent with these prior decisions, because the NGA

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[5] J.A. 306; Supp. App. at SA-1 to SA-2.

[6] J.A. 318, 1087; Supp. App. at SA-2 to SA-3, SA-27 to SA-28.

[7] J.A. 318-321, 1087; Supp. App. at SA-2 to SA-5, SA-27 to SA-28.

[8] INGAA App. 30a.

[9] As used herein "Petitioners" means the Petitioners in Nos. 87-976, 87-977, and 87-979.

[10] 410 U.S. 336 (1973).

[11] Florida Power & Light Co. v. FERC, 660 F.2d 668 (5th Cir. 1981), *cert. denied*, 459 U.S. 1156 (1983); New York State Electric & Gas Corp. v. FERC, 638 F.2d 338 (2nd Cir. 1980), *cert. denied*, 454 U.S. 821 (1981); Richmond Power & Light v. FERC, 574 F.2d 610 (D.C. Cir. 1978).

and Federal Power Act ("FPA")[12] are to be read in *pari materia*.[13] Petitioners contend that, given this limitation on the Commission's power to order wheeling, the anti-discrimination provisions of neither act give the Commission the power to require a pipeline to transport gas belonging to another against its will.[14]

This argument ignores a key factor recognized by the court of appeals below. In *Otter Tail*, this Court held that a district court could require wheeling, *where not to require it* would permit the electric company to violate the antitrust laws. This Court affirmed that the enactment of the Federal Power Act did not interpose a defense against an antitrust suit in a district court.

While *Otter Tail* might prove a precedent against a general assertion of jurisdiction by the Commission to impose common carriage, that case does not address the issue presented here, to-wit: whether the Commission may order non-discriminatory transportation as a remedy for anti-competitive conduct or undue discrimination. Here the Commission *made a finding* that the pipelines were engaged in anti-competitive practices by refusing to transport gas belonging to other shippers which would displace sales formerly made by the pipelines themselves.[15] In any event, the Commission did not *order* pipelines to transport gas on behalf of others; on the contrary, it made it very clear that the pipelines could choose *not* to transport for others.[16] What the Commission said

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[12] 16 U.S.C. § 791a, *et seq.*

[13] Contrary to the holding of the court of appeals, *see* INGAA App. 28a.

[14] Texas Eastern Petition (No. 87-977) at 11.

[15] J.A. 1086; Supp. App. at SA-26 to SA-27.

[16] J.A. 352-357, 1085; Supp. App. at SA-10 to SA-15, SA-26.

was, "if you choose to transport gas for others, you must do so on a non-discriminatory basis." [17]

Under this Court's decisions in *FPC v. Conway Corp.*[18] and *Gulf States Utilities Co. v. FPC*,[19] the Commission is *required* to consider the anti-competitive effects of regulated aspects of interstate utility operations, and should it find that those aspects are present, it may take remedial steps to foster competition.

The decisions of the courts of appeals cited by Petitioners do not create a conflict among the circuits requiring this Court's intervention. Indeed, a close reading of these cases suggests that the Commission's power to order wheeling of electricity in the face of a clear showing of anti-competitive conduct has not yet been decided. In *Florida Power*, the Fifth Circuit explicitly pretermitted a decision on such an argument.[20] In *New York State Electric & Gas*,[21] the Second Circuit stated that *were* the Commission to require wheeling as a remedy for an unreasonable contract provision under Section 206 of the FPA, it would be required to use the specific wheeling authorization added by Congress in 1978.[22]

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[17] Such a finding was required by the D.C. Circuit's opinion in Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985); J.A. 1086; Supp. App. at SA-26 to SA-27.

[18] 426 U.S. 271, 278-80 (1976).

[19] 411 U.S. 747, 758-59 (1973).

[20] Florida Power & Light Co. v. FERC, *supra*, 660 F.2d at 679.

[21] New York Electric & Gas Co. v. FERC, 638 F.2d at 403.

[22] Section 203 of the Public Utility Regulatory Policies Act of

[22] 16 U.S.C. § 824e. Section 203 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), P.L. 95-617, 92 Stat. 3117, 3136-40, *codified as* Sections 211 and 212 of the FPA, 16 U.S.C. §§ 824j & 824k. The wheeling provisions of Sections 211 and 212 were added by PURPA to deal with the perceived need to assist cogenerators and small power producers. This points out differences between the electric and natural gas industries, which sometimes call for different Commission responses to similar statutory language. (*Cf.* Natural Gas Pipeline Company of America v. FERC, 765

There being no similar specific statutory mechanism in the NGA, *New York State Electric & Gas* cannot be read to preclude the ordering of transportation by interstate pipelines to prevent discrimination.

In *Richmond*, as noted by the court of appeals, the petitioner failed to make a showing of anti-competitive or discriminatory impact resulting from the refusal of other utilities to wheel power.[23] The Commission and the District of Columbia Circuit simply rejected a *per se* rule equating refusals to wheel with discriminatory or anti-competitive practices. In this case, the Commission made express findings of anti-competitive practices. These findings distinguish this case from *Florida Power*[24] and *Richmond*,[25] where no such findings were made. This distinction is clearly articulated in the opinion of the court of appeals.[26]

C. *FCC v. Midwest Video Corp.*[27] And The Other Television Cases Are Not In Point.

All three Petitioners, particularly City of Willcox, rely on *FCC v. Midwest Video Corp.* as controlling authority requiring reversal of the court of appeals and the Commission. We agree with the court of appeals that these cases are distinguishable from the case at bar.

FCC v. Midwest Video Corp. is the last in a series of cases[28] which explored the First Amendment right of

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F.2d 1155, 1167-68 (D.C. Cir. 1985) (discussing "the complex policy questions" which justified the Commission treating abandoned gas projects differently from abandoned electric projects.))

[23] Richmond Power & Light v. FERC, *supra*, 574 F.2d at 623.

[24] 660 F.2d at 679.

[25] 574 F.2d at 623.

[26] INGAA App. 28a-30a. *See also* Central Iowa Power Coop. v. FERC, 606 F.2d 1156 (D.C. Cir. 1979).

[27] 440 U.S. 689 (1979).

[28] FCC v. Pottsville Broadcasting Co., 309 U.S. 134 (1940); United States v. Southwestern Cable Co., 392 U.S. 157 (1968);

freedom of speech in relation to the Federal Communications Act, and that Act's purpose to preserve a degree of editorial control in the broadcaster or cable operator. In *Midwest Video*, the Court held that in the face of a direct prohibition in Section 3(h) of the Federal Communications Act [29] against "treating broadcasters as common carriers," the Federal Communications Commission could not require a cable television operator to maintain specific channels for the use of the public. No questions of anti-trust violations or anti-competitive activity by the broadcasters were presented. Instead the Court gave effect to the legislative purpose of the Federal Communications Act which was designed to "safeguard the journalistic freedom of broadcasters." [30] In *United States v. Southwestern Cable Co., supra*, this Court had upheld the power of the Federal Communications Commission to prohibit certain anti-competitive actions by a television station, which the Court held did *not* make the station a common carrier.[31] This is similar to the action taken by the Commission and upheld by the court of appeals below.

While conceding that the accomplishment of the purpose intended by Congress is a key element in interpreting the extent of the Commission's jurisdiction,[32] the City of Willcox makes the astonishing assertion that the NGPA "was not intended to promote competition in either the interstate or intrastate pipeline fields." [33]

Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969); United States v. Midwest Video Corp., 406 U.S. 649 (1972); Columbia Broadcasting System, Inc. v. Democratic National Committee, 412 U.S. 94 (1973).

[29] 47 U.S.C. § 153(h).

[30] FCC v. Midwest Video Corp., *supra*, 440 U.S. at 700.

[31] United States v. Southwestern Cable Co., *supra*, 392 U.S. at 169 note 29 (1968).

[32] City of Willcox Petition (No. 87-979) at 12.

[33] *Id.* at 13.

Contrary to the assertion made by the City of Willcox, the Commission's responsibility to consider competitive factors is clear.[34] This Court's decision in *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*,[35] referred to "Congress' determination that the supply, the demand, and the price of high-cost gas be determined by market forces" in the NGPA.[36] The controlling effect of the "market forces" over prices cannot occur, as the Commission below found, where it is prevented by the anti-competitive actions of interstate pipeline companies.[37] Competition at the wellhead is promoted by the NGPA. Competition cannot be effective at the burner tip unless pipelines are prevented from discriminating in favor of their own gas supplies in delivering gas to the ultimate consumer.

In the *Maryland People's Counsel* cases,[38] the District of Columbia Circuit reversed the Commission's earlier efforts to insert competition into sales at the market end of interstate pipelines, on the grounds that it did not go far enough in ensuring that *all* pipeline customers could take advantage of the newly available supplies.[39] Those

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[34] Central Iowa Power Coop. v. FERC, 606 F.2d 1156, 1162 (D.C. Cir. 1979); Central Power & Light Co. v. FERC, 575 F.2d 937, 938 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 981 (1978); Gulf States Utilities Co. v. F.P.C., 411 U.S. 747 (1973).

[35] 474 U.S. 409 (1986). *See also* Gulf States Utilities Co. v. FPC, 411 U.S. 747 (1973).

[36] Transcontinental Gas Pipe Corp. v. State Oil and Gas Board of Mississippi, *supra*, 474 U.S. at ——; 106 S.Ct. at 717, 88 L.Ed.2d at 744. *See also* Public Service Commission of New York v. Mid-Louisiana Gas Co., 463 U.S. 319, 331-32 (1983).

[37] J.A. 1087; Supp. App. at SA-27 to SA-28.

[38] Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985); Maryland People's Counsel v. FERC, 768 F.2d 450 (D.C. Cir. 1985).

[39] 761 F.2d at 788-89.

cases specifically directed the Commission to consider competitive factors, finding that this Court's instruction in *Atlantic Refining Company v. Public Service Commission* required the Commission to "afford consumers a complete, permanent and effective bond of protection from excessive rates and charges," [40] and that competition was one way of achieving this result.[41] Order No. 436 was the Commission's response to the mandate of the District of Columbia Circuit in the *Maryland People's Counsel* cases.[42] The court below found the Commission's response to be reasonable.[43]

D. The Orders Below Do Not Force Interstate Pipelines To Become Common Carriers.

1. *Pipeline Participation In The Order No. 436 Program Is Voluntary.*

The Commission repeatedly stated that participation in the Order No. 436 open-access transportation program was voluntary on the part of the interstate pipeline, and if the pipeline chose to continue operations as before, it could do so.[44] The Petitioners assert that in reality pipelines are forced to participate in the program or lose out on the competitive market to other pipelines who are willing to accept the drawbacks of the program in return for its advantages. Petitioners refer to the statement of the court of appeals that "inability to provide blanket certificate transportation for fuel-switchable users may in current market circumstances cause critical load loss," [45] forcing the pipelines into a choice between being

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[40] 360 U.S. 378, 388 (1959).

[41] 761 F.2d at 777.

[42] J.A. 356-357, 1086; Supp. App. at SA-13 to SA-15, SA-26 to SA-27.

[43] INGAA App. 31a-34a.

[44] J.A. 355-356, 1082-1086; Supp. App. at SA-12 to SA-14, SA-23 to SA-27.

[45] INGAA App. 81a.

shot and hanged.[46] Any adverse consequences to the pipeline of continuing to operate as it did before Order No. 436 are the result of market forces, not of Commission action "forcing" that pipeline to become a common carrier. As the court of appeals observed, "nothing bars the Commission from devising rules that remedy a lack of competition by exposing pipelines to competition and its normal consequences."[47] This Court held in *Market Street Railway v. Railroad Commission*, that regulation was not designed to protect regulated companies from losses brought about by market conditions.[48]

As the Commission noted in the Orders below, Order No. 436 "does not direct or 'mandate' a pipeline to do anything."[49] It only requires that when a pipeline *does* choose to transport on a self-implementing basis, it must provide those transportation services in a non-discriminatory manner.[50] A pipeline remains free to seek authorization for other transportation not covered by the condition and the Commission will review such requests on a case-by-case basis.[51]

The Commission pointed out the "all important distinction" between common carriage and the Order No. 436 open-access transportation program—the fact that the pipeline continued to have the option to provide transportation services under NGA Section 7 certificates, and a pipeline could cease transporting under the Order No. 436 program and revert to its former status.[52] Unlike

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[46] *Id.*; *See* Texas Eastern Petition (No. 87-977) at 8.

[47] INGAA App. 32a-33a.

[48] 324 U.S. 548, 566-67 (1945).

[49] J.A. 1082-1083; Supp. App. at SA-23 to SA-24.

[50] *Id.*

[51] *Id.*

[52] J.A. 1085; Supp. App. at SA-26.

the mandatory common carriage proposals considered by Congress but not enacted,[53] the Order No. 436 open-access program effectively allows the pipeline the discretion to determine whether or not to become a transporter of gas belonging to others.[54]

The Commission's open-access program was found to be necessary to prevent an interstate pipeline from engaging in the unduly discriminatory practice of refusing to transport gas for others where to do so would displace its own sales.[55] In order to avoid the unlawful discrimination which the District of Columbia Circuit warned against in the *Maryland People's Counsel* cases, *supra*, the pipeline was required to choose one of three alternatives:

> (i) It could refuse to transport gas belonging to others at all.
>
> (ii) It could transport gas for others under individual certificates issued pursuant to Section 7 of the NGA.
>
> (iii) It could transport gas under the blanket certificates authorized by Order No. 436 *provided it agreed to do so without discrimination.*

Moreover, the pipeline can change its mind and shift from one role to another. While the pipeline might obtain some commercial advantage out of accepting the Order No. 436 blanket certificate, it is certainly not required by the Commission's Order to do so. By no stretch of the imagination does this rise to the level of imposing mandatory common carriage upon the interstate pipelines.

2. Non-Discrimination Is Not Common Carriage.

All three Petitioners make the unwarranted assumption that because the Order No. 436 transportation re-

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[53] INGAA Petition (No. 87-976) 9-10; City of Willcox Petition (No. 87-979) at 12-15; Texas Eastern Petition (No. 87-977) at 6-8.

[54] J.A. 1085; Supp. App. at SA-26.

[55] *Id.*

quires pipelines *which elect to transport under blanket certificates* to do so without discrimination on a first-come, first-served basis, that the Commission has imposed "common carrier status" upon them.[56] But the imposition of one of the attributes of common carriage as a condition to the non-compulsory participation in a particular transportation program does not confer "common carrier status" on interstate pipelines.[57] This distinction is clearly made in *FCC v. Midwest Video Corp., supra.*[58] The NGA, as distinguished from the Federal Communications Act, contains no prohibition against imposing "common carrier obligations" upon interstate pipelines in limited circumstances where the failure to do so would result in undue discrimination, which is directly prohibited by the NGA.[59]

E. Order No. 436 Does Not Violate Section 602(b)(2) Of The NGPA.[60]

Petitioners[61] assert that Order No. 436 violates the provisions of Section 602(b)(2) of the NGPA which provide in pertinent part:

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[56] INGAA Petition (No. 87-976) at 7; City of Willcox Petition (No. 87-979) at 5-6; Texas Eastern Petition (No. 87-977) at 5-6.

[57] The *NARUC* cases (National Ass'n of Regulatory Utilities Comm'n v. FCC, 525 F.2d 630 (D.C. Cir. 1976), *cert. denied*, 425 U.S. 992 (1976); National Ass'n of Regulatory Utilities Comm'n v. FCC, 533 F.2d 601 (D.C. Cir. 1976)) cited by City of Willcox at 9 are not in point. The District of Columbia Circuit noted in *NARUC II* "a carrier will not be a common carrier where its practice is to make individualized decisions in particular cases whether and on what terms to serve" (533 F.2d at 608-09). Under Order No. 436, an interstate pipeline has the option to commence or discontinue open-access transportation.

[58] 440 U.S. at 701-02.

[59] INGAA App. 26a-27a.

[60] 15 U.S.C. § 3432(b). This Section is entitled "Effect on state laws" which supports the court of appeals' conclusion as to its purpose, *see* INGAA App. 34a-37a.

[61] City of Willcox Petition (No. 87-979) at 10; INGAA Petition (No. 87-976) at 15; Texas Eastern Petition (No. 87-977) at 9.

> No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—
>
> . . . .
>
> (2) authorized by the Commission under Section 311(a) of this Act.

The short answer to this argument is that neither under Order No. 436 nor any other Order has the Commission subjected interstate pipelines "to regulation as a common carrier." [62] Petitioners confuse the limited imposition of one of the obligations of a common carrier, only where the pipeline elects to transport under the Order No. 436 program and only where necessary to prevent discrimination and monoplistic practices, with "regulation as a common carrier." The discussion of this argument by the court of appeals defends both its interpretation and that of the Commission: [63]

> The reasonableness [of FERC's interpretation of § 602(b)(2)] is underscored by FERC's broad duties to assure consumers access to natural gas at prices such as would prevail in the absence of pipeline market power and its conclusion that under the present circumstances fulfillment of that duty required such conditioning. *Cf. American Trucking Ass'n, Inc. v. Atchison T. & S.F. Ry. Co.*, 387 U.S. 397 (1967). . . .[64]

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[62] The Commission so found, (J.A. 1084; Supp. App. at SA-25) and the court of appeals agreed (INGAA App. 35a-39a).

[63] INGAA App. 35a-39a.

[64] INGAA App. 37a.

II. The Optional Expedited Certificate Procedure Established By The Commission's Orders Represents A Valid Exercise Of The Commission's Authority And Contains Provisions Which Are Not Ripe For Review.

A. The Optional Expedited Certificate Procedure's Substantive Provisions Are Within The Commission's Discretionary Authority And Will Not Interfere With State Jurisdiction.

Southern California Gas Company ("SoCal") seeks review of the Optional Expedited Certificate Procedure ("OECP") on grounds that, in adopting the "rebuttable presumption" comprising the heart of the rule, the Commission abdicated its responsibilities under the NGA, neglected to consider the risk of duplicative or wasteful facilities, and failed to adequately consider the potentially adverse impact which "LDC bypass" [65] may inflict on the local distribution companies' customers. To the contrary, however, both the Commission, in Order Nos. 436 and 436-A, and the court of appeals fully considered all relevant factors and determined that the provisions of the OECP minimized any potentially adverse impact while adequately discharging the Commission's statutory responsibilities. Recognizing Congress' primary objective in enacting the NGA's certificate requirement is to avoid ratepayer subsidization of duplicative or economically wasteful projects and decisions, the Commission structured the OECP so as to guard against "risk-shifting" to pipeline customers and the public.[66] Additionally, the Commission designed the OECP so that, once an applicant has initially met *prima facie* criteria showing that it will

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[65] "LDC bypass" involves situations where an end-user secures pipeline transportation of natural gas purchased directly from producers and other gas merchants thereby bypassing the local distribution company servicing the area in which the end-user is located. SoCal App. at C-108 ("SoCal App." refers to the appendix submitted with the petition in No. 87-1091).

[66] INGAA App. at 112a.

assume the full economic risk of the venture, local distribution companies, customers and other affected parties may, through a challenge to the applicant's factual showing raising relevant offsetting factors, prompt evaluation of any potential impact on competition.[67] Finally, through an economic and regulatory analysis of "LDC bypass" and its pro-competitive effects, both the Commission and the court of appeals concluded that any adverse impact to local distribution companies or their customers is a function of, and may be minimized by, the policies and practices of state regulatory agencies.[68] The Commission's choice of procedures to discharge its responsibilities under Section 7(c), resting on careful and reasoned analysis, is within its discretion to make and cannot be viewed as arbitrary and capricious.[69]

SoCal's claims that the OECP creates a "regulatory gap" and interferes with state jurisdiction likewise have no merit. SoCal argues that, since the OECP fails to allow a meaningful review of bypass applications, the absence or uncertainty surrounding state regulation to adequately handle bypass means that the OECP must fail. These arguments, however, fail to discern the interrelationship between federal and state authority and ignore the fact that the OECP will continue to allow the Commission and state regulatory agencies to continue to act within their respective spheres of authority. Regardless of whether the Commission discharges NGA jurisdiction through the traditional certificate process or the OECP, the scope of the Commission's authority remains well defined and is intended to supplement state author-

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[67] SoCal App. at C-111, C-121 and D-77.

[68] SoCal App. at C-108, C-109, D-76, D-77; INGAA App. at 106a-107a.

[69] Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29, 43 (1983), *quoting* Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962).

ity.[70] The court of appeals recognized this bright-line delineation of authority in stating that the "Commission fulfills its mission under the [NGA] if it establishes conditions by which gas arrives in the hands of consumers or LDCs on terms that conform to the Act." [71] Viewed in these terms, the OECP neither expands nor restricts the scope of complementing state authority to regulate the "LDC bypass."

B. The Optional Expedited Certificate Procedural Provisions Are Not Ripe For Review.

In contrast to issues concerning the Commission's authority to adopt the OECP, the court of appeals correctly determined that SoCal's complaints as to the procedural aspects of the rule are not sufficiently ripe for review.[72] In addition to directly challenging the Commission's authority to streamline the traditional certificate process, SoCal attempts to raise a number of attacks on the procedural aspects of the OECP's presumption provisions which the court of appeals characterized as "highly abstract and speculative." [73] Review by this Court at this time is premature at best and should be deferred pending a final formulation of the Commission's optional certificate regulations.

It is clear that SoCal's complaints concerning the procedural provisions of the OECP are only theoretical and

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[70] FPC v. East Ohio Gas Co., 338 U.S. 464 (1950). *See* H.R. Rep. No. 709, 75th Cong., 1st Sess. 2 (1937).

[71] INGAA App. at 108a. Whether and the extent to which states may regulate "LDC bypass" or interstate gas sales to end-users is a separate question which has no direct bearing on the scope of the Commission's NGA-based authority over pipeline transportation. *See, e.g.*, Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 341 U.S. 329 (1951); Panhandle Eastern Pipe Line Co. v. Public Service Commission of Indiana, 332 U.S. 507 (1947).

[72] INGAA App. at 97a-102a.

[73] INGAA App. 100a-101a.

speculative at this juncture. Thus, review by the Court would result in a premature adjudication in the nature of an advisory opinion.[74] As the court of appeals acknowledged below, the procedural issues raised by SoCal has not yet been addressed by the Commission or the courts in a specific factual context.[75] Since these issues, including specifically the effect of the "rebuttable presumption," can be contested and reviewed in specific proceedings before the Commission, the OECP in its present form does not present issues which are fit for judicial decision and no hardship to SoCal can result from withholding a generic and abstract consideration of the OECP at this time.

CONCLUSION

The Petitions for Certiorari in Nos. 87-976, 87-977, 87-979 and 87-1091 should be denied.

Respectfully submitted,

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[74] Abbott Laboratories v. Gardner, 387 U.S. 136 (1967).

[75] INGAA App. at 100a-101a.

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SUPPLEMENTAL APPENDIX

SUPPLEMENTAL APPENDIX

EXCERPTS FROM ORDER NO 436

[JA 305]

* * * *

An interstate pipeline, however, seeking to sell gas from its system supply (a commingled stream of gas that was at the wellhead both NGA-jurisdictional and NGA-non-jurisdictional) is subject to the full panoply of statutory regulation governing market entry, market exit and price. As a result, *even for already certificated sales to existing customers*, it may change its rates only upon 30 days advance notice. It must supply extensive documentation detailing each and every source of natural gas supply, including an identification of the seller, the location, and the price. If it seeks to provide a new service to an existing customer, it must file for and obtain a section 7(c) certificate authorizing the new service. Any party opposing the new market entry has a right to explore genuine issues of material fact in a contested, trial-type hearing.

The rationale for maintaining utility-type market entry, exit, and price regulation over the sales for resale of interstate pipelines while removing that regulation for similar sales by other market entities is only implicit in the NGPA but appears plain enough: While Congress concluded that gas production was [JA 306] sufficiently competitive to remove regulation, the control which interstate pipelines exercised over transportation still conferred on them the same kind of market power over their customers as had existed at the time of enactment of the NGA.[39]

If customers had access to transportation for gas which they purchase directly in the competitive, commodity market, the pipeline would find itself at a serious competitive disadvantage in marketing gas in competition with

producers and other entities because the regulatory rules as to market entry, exit and price would deprive it of the flexibility to meet the competition. We have *already* seen a good deal of that with the development of the spot market, the resulting decline in pipeline sales and increased use of transportation. And with the advent of repeated out-of-cycle PGA filings, we have seen what may be the beginnings of a virtual "posted price" approach to gas at the resale end where pipelines compete against other pipelines.[40]

Yet a pipeline that accepts the open access condition tendered in the final rule will have agreed to provide its customers with that access, thereby accelerating the process. This would thus require those pipelines that wish to remain merchants to seek greatly increased pricing flexibility.

• • • •

[JA 318]

5. The pipelines have generally expressed a reluctance to provide these transportation services on a nondiscriminatory basis to their existing sales customers[88] or to customers without immediate fuel-switching capability, such as residential and commercial consumers.[89]

   a. With respect to incremental volumes (*i.e.*, gas that would not displace a sale by the pipeline itself from its own contracted-for supply), pipelines generally do not have adequate incentives to provide this service as long as the pipeline's rate structure requires the crediting to the pipeline's sales customers of essentially all revenues received from the transportation. The regulations allowed the pipeline to elect an option pursuant to which costs would be allocated to the transportation service (allowing retention of the revenues), but until fairly recently most major pipelines had not elected that option.[90] Moreover,

the pipelines have been under no legal obligation to elect the revenue retention option. Once pipelines began to design their rates to allocate costs to the transportation service, thereby obtaining the right to retain revenue, the ratemaking rationale for declining to transport incremental volumes has diminished.

[JA 319]

b. With regard to volumes of gas that would displace a sale by the pipeline from its own contracted-for supply, the situation has been somewhat more complex.

(i) Where the pipeline's take-or-pay exposure was so great that it believed that prepaid gas would never be able to be "made up," the pipeline faced the possibility of forfeiting the entire principal amount of the prepayment. Under these economic circumstances, even where the pipeline was able to retain the revenues received from providing transportation, the pipeline would still lose money were it to transport gas that would displace a unit of contracted-for gas. The more gas it transported, the more money it would lose. Under these circumstances the pipeline's reluctance to transport was at its height. Accordingly, it is important to provide flexibility for pipelines and producers to renegotiate these contracts, to review "buy-outs," "buy-downs" and to provide for expedited treatment of limited term and permanent producer abandonment and certificate requests.

[JA 320]

(ii) Where the pipeline's take-or-pay exposure was *not* so great as to confront it with the

prospect of forfeiting prepayments, the question was more one of fixed cost allocation. If the pipeline had to finance the prepayments, who should bear the burden of the carrying charges, the fixed costs associated with the prepayment: the sales customers, the transportation customers, the producer (by not being paid in accordance with the contract), or the pipeline's shareholders?

6. As a result of the pattern of contractual arrangements developed by the industry during previous eras of pipeline expansion [91] and supply curtailment,[92] such as take-or-pay and minimum bill provisions,[93] customers of pipelines have been allocated a large part of the risk that gas supplies deregulalated by the NGPA might prove unmarketable over the life of contracts signed by producers and pipelines.

In turn, the Commission's administration of its ratemaking and certificate obligations under the NGA [94] has impeded the ability of natural gas consumers to secure the rewards of competition in natural gas markets commensurate with the risks [JA 321] that have been allocated to them by pipelines and producers.

In particular, the Commission's policy of full rolled-in pricing of price-controlled and deregulated gas supplies has frustrated the transmission of clear and accurate price signals between the city-gate and the wellhead,[95] and has permitted pipelines to bid up new gas prices above market-clearing levels.[96]

The Commission's policy of discouraging the flexible entry and exit of new pipeline services from natural gas markets is thwarting the expansion of the interstate pipeline system in order to provide

for changing end-uses of gas[97] and changing locations of new gas fields.[98]

7. As a result, average delivered prices of gas are not adjusting downwards in line with the decline in field prices,[99] and this failure is causing unnecessarily high energy costs to consumers and a very large loss to the American economy in jobs, production, and net economic efficiency.[100]

* * * *

[JA 346]

2. *Commission authority to prescribe the non-discriminatory access condition.*

   a. *Authority to impose on interstate transportation by interstate pipelines.*

The proposed rule provided that self-implementing transportation authorizations under section 311 of the NGPA and blanket transportation certificates issued under section 7 of the NGA would be subject to an express non-discriminatory access condition. The express condition provided that any interstate or intrastate pipeline that provides any transportation service pursuant to such authority or certificate shall provide such service for all shippers willing to pay the applicable tariff rate on file with the Commission for the service requested, without discrimination in the quality of service provided, the categories, prices, or volumes of natural gas transported, customer classification, or discrimination of any kind.

[JA 347]

Comments

Some commenters misunderstood the non-discriminatory access condition to require that *all* self-implementing transportation requests, including patently unreasonable requests, be accepted by transporters.[6]

Commission Response

This was not the Commission's intent. Therefore, the non-discriminatory access condition has been revised in the final rule to insert the word "undue" to track the NGA statutory standard.[7] The final rule thus is intended to prohibit undue discrimination, or preference, including but not limited to undue discrimination or preference in the quality of service; duration of service; categories, prices, or volumes of gas transported (including as between affiliated and non-affiliated producers or shippers); and customer classification (including whether or not transportation would displace sales to an existing sales customer of the transporting pipeline).

Moreover, the final rule expressly provides that a pipeline may impose reasonable operational conditions on any request for self-implementing service. See sections 284.8 (c) and 284.9(c). Such conditions are required to be made a part of the pipeline's tariff, however, and thus will be subject to public scrutiny and Commission review. *Id.*

Comments

Most of the commenters who address the non-discriminatory access conditions support the Commission's proposal. Those in [JA 348] favor of the proposal include a quarter of the major interstate pipelines, nearly half the intrastate pipelines, a majority of local distribution companies (LDCs) and virtually all industrial end-users, producers and public entities. The majority of interstate and intrastate pipelines oppose the proposal.[8]

Those in favor of the non-discriminatory access condition generally state that it is necessary in order to effectuate the consumer protection and competition goals of the NGA and NGPA. They assert that it is reasonable in light of the increased demands for transportation of lower-priced gas in natural gas markets, and that it should be clearly stated and broadly applied in order to

avoid evasion by pipelines on a case-by-case basis. They conclude that the Commission has legal authority to impose the condition.

The majority of commenters support the application of the non-discriminatory access condition to pipelines that choose to participate in the Commission's self-implementing transportation programs. They generally indicate the view that the Commission has sufficient authority to implement the non-discriminatory access condition under both NGA section 7(e), which grants the Commission authority to attach reasonable conditions to certificates, and NGA sections 4(b) and 5(a), which prohibit undue discrimination or preference in rates, charges, or practices.[9]

Among the cases cited in support of the Commission's authority under the NGA to impose the non-discriminatory access condition [JA 349] are: *Gulf Oil Corporation v. FPC*, 563 F.2d 588, 596-97 (3rd Cir. 1977) and *American Trucking Association, Inc. v. Atcheson, Topeka, & Sante Fe Railway Company*, 387 U.S. 397 (1967). Process Gas Consumers Group (PGC) also cites several cases in which the courts have read NGA section 7 very broadly to uphold certificate conditions imposed by the Commission; *Atlantic Refining Company v. PSC*, 360 U.S. 378 (1959); *Transcontinential Gas Pipeline Co. v. FERC*, 589 F.2d 186, 190 (5th Cir. 1979), *cert. denied*, 445, U.S. 915 (1980) (conditioning of certificates to ensure appropriate allocation of risk); and *Alabama-Tennessee Natural Gas Co. v. FPC*, 203 F.2d 494 (3rd Cir. 1953) (imposition of rate conditions).

The main argument of the commenters that oppose the non-discriminatory access provision is that the condition would, in effect, subject interstate and intrastate pipelines to regulation as common carriers.[10] According to these commenters, while participation in the self-implementing program may be voluntary, participation

for all practical purposes is mandatory because pipelines will be forced by economic and competitive necessity to participate in the program in order to remain financially viable. Others argue that the non-discriminatory access provision could have the effect of imposing increased costs on customers, such as take-or-pay costs when transportation displaces sales.[11]

Furthermore, these commenters argue that the Commission does not have legal authority to apply the condition to either certificates issued under section 7 of the NGA or self-implementing transportation authorized under section 311 of the NGPA.

[JA 350]

Several of the commenters point to the legislative history of the NGA in support of their view that the Commission is abusing its section 7 conditioning authority in attempting to do indirectly that which Congress has expressly declined to give the Commission authority to do directly, i.e., make pipelines common carriers.[12] These commenters point to the express omission of common carrier authority in the legislative history of both the NGA and NGPA, as well as several legislative proposals to impose non-discriminatory access or express common carrier requirements on natural gas pipelines which have been introduced in Congress but not enacted since enactment of the NGA.[13]

For example, Panhandle Eastern Pipe Line notes that there has been but one exception to what it perceives as Congress' long-standing reluctance to legislate common carriage by natural gas pipelines. That exception is the requirement in the Outer Continental Shelf Lands Act of 1978, 42 U.S. §§ 1334(e) and (f), that natural gas pipelines to which the Secretary of the Interior has granted authority to transport Outer Continental Shelf (OCS) gas must provide transportation on a non-discriminatory basis. Panhandle reasons that the absence

of a similar provision in the NGA and NGPA demonstrates that Congress concluded that the Commission should not have the authority to require that pipelines authorized to transport natural gas under those Acts do so in a non-discriminatory manner.

[JA 351]

Intrastate pipelines and their state regulatory bodies assert that the access condition is an unsupportable attempt to pre-empt state regulation of intrastate activities.[14]

Commission Response

In considering those comments that suggest the Commission lacks legal authority to apply the non-discriminatory access condition to interstate transportation under the NGA the Commission has reviewed the requirements of the NGA, including legislative history and relevant case law.

Section 7(e) of the NGA states, in pertinent part, that:

> The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

According to the Supreme Court:

> The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges . . .
>
> . . . In view of this framework in which the Commission is authorized and directed to act, the initial certification of a proposal under §7(e) of the Act as being required by the public convenience and necessity becomes crucial. This is true because the delay

> incident to determination in § 5 proceedings through which initial certificated rates are reviewable appears nigh interminable.[15]

Thus, the Commission's certificate and conditioning authority is the means by which it effectuates the purpose of the NGA to underwrite just and reasonable rates to the consumers of natural gas.[16] Any attack on a condition in a certificate issued by the Commission must confront the well-established principle that [JA 352] generally the Commission has extremely broad authority to condition certificates of public convenience and necessity.

This broad conditioning authority must be examined in the context of Congress' consideration of the NGA itself. It is abundantly clear from the history of the Act and from the events that prompted its adoption that Congress considered the natural gas industry to be heavily concentrated and that monopolistic forces were determining the amount of natural gas that could be marketed by fixing the amount that could be transported.[17]

Thus, section 7(e) of the NGA gives the Commission the power to attach conditions to certificates where required by the public convenience and necessity.

Beyond section 7, however, sections 4 and 5 of the NGA also prohibit unduly discriminatory or preferential practices by natural gas companies. The Commission has determined that the practice of restricting access to transportation is unduly discriminatory and preferential; and, importantly, has prevented consumers from obtaining the lowest reasonable rates for both transmission services and gas costs. Therefore, the Commission intends the final rule to be an exercise of its conditioning authority to effectuate the non-discrimination requirements of the Act and to ensure that consumers will obtain gas and transportation at just and reasonable rates.

Given the breadth of our section 7 conditioning authority and our obligation under sections 4 and 5, we must ask whether the proposed non-discriminatory access condition is so broad as [JA 353] to impose, either directly or indirectly, common carrier obligations on pipelines in violation of the NGA.

Notwithstanding the basis of the condition in sections 4, 5 and 7 of the NGA, several commenters have asserted that Congress failed to enact amendments to the NGA which would have imposed mandatory transportation requirements on natural gas pipelines, and therefore the NGA by implication does not authorize the Commission to impose common carrier status on pipelines.[18]

Of key interest to the Commission in its review of the legislative history are sections 303 and 304 of Title III of H.R. 5423 introduced in 1935 by Representative Sam Rayburn, Chairman of the House Committee on Interstate and Foreign Commerce.[19]

Sections 303 and 304 of H.R. 5423 provided in pertinent part (emphasis added):

> Section 303(a). *It shall be the duty of every distributor to* furnish natural gas, to exchange natural gas with, and *transmit natural gas for any person* upon reasonable request therefor; and to furnish and maintain such services and facilities as shall promote the safety, comfort and conveniences of all its customers, employees, and the public, and shall be in all respects adequate, efficient and reasonable . . .
>
> Section 304. Whenever the Commission after notice and opportunity for hearing finds such action necessary or desirable in the public interest, *it may by order direct a distributor* to make additions, extensions, repairs, or improvements to or changes in its facilities, to establish physical connection with the facilities of one or more persons, to permit those

> of its facilities by one or more persons, or utilize the facilities of, sell natural gas to, purchase natural gas from, *transmit natural gas for*, or exchange natural gas with *one or more other persons* . . . [T]he **[JA 354]** Commission may prescribe the terms and conditions of the arrangement to be made between such persons, including the apportionment of reimbursement reasonably due to any of them.[20]

If these sections would have imposed common carrier obligations on natural gas pipelines, and therefore were rejected by Congress, a principal attribute of common carrier status must be its *mandatory* nature. Thus, section 303 would have imposed an affirmative "duty" on pipelines to "transmit" natural gas "for any person." Section 304 would have provided the Commission with the concomitant authority to "by order direct" any pipeline to "transmit natural gas for . . . one or more other persons . . . ."

Sections 303 and 304 must be read in the context of sections 4(b) and 5(a) of the NGA as enacted. In contrast to proposed section 303's affirmative duty, section 4(b) flatly prohibits "any undue preference or advantage" and "any reasonable difference" in service or as between classes of service. In contrast to proposed section 304's discretion to *order* transportation, section 5(a) contains *no express authority to order transportation.* Instead, section 5 permits the Commission to find that "any rule, regulation, practice or contract" affecting transportation rates, charges or classifications is ". . . unduly discriminatory, or preferential" and thereafter fix prospectively by order the "just and reasonable . . . rule, regulation, practice or contract" to be observed.

On the one hand, sections 303 and 304 would have imposed an affirmative duty on pipelines to transport for others and backed **[JA 355]** up that duty with discretionary authority on the part of the Commission to order such transportation.

On the other hand, sections 4, 5, and 7 of the NGA attach non-discrimination obligations to the "practices" of pipelines and back up those obligations with broad conditioning authority on the part of the Commission. But the Natural Gas Act does not expressly *require* pipelines to transport for others as an affirmative duty.

We have considered whether the non-discriminatory access condition in the final rule amounts to a "direction" or a "mandate" to pipelines to transport for others as an "affirmative duty." First, the condition is just that: a *condition* on the certification or authorization of certain self-implementing transportation services which a pipeline may *voluntarily choose to perform or not*, strictly at its own option. Thus, it does not "direct" or "mandate" a pipeline to do anything. Second, the condition, even when accepted by a pipeline as part of its self-implementing transportation program, does not impose any "affirmative duty" on a pipeline to transport. It only requires that when a pipeline *does* choose to transport on a self-implementing basis, it must provide those transportation services in a non-discriminatory manner. Nor does the condition cover all transportation services and thus operate as mandatory *in effect*. A pipeline remains free to seek authorization for other transportation programs not covered by the condition and the Commission will review them on a case-by-case basis.

[JA 356]

In addition, the condition expressly applies, verbatim, the statutory prohibitions on unduly discriminatory or preferential practices, rates or charges imposed by Congress when it enacted sections 4 and 5 of the NGA.[21]

The Commission need not decide in this rulemaking whether it may ever order transportation on a mandatory basis. The Commission plainly has broad powers to enforce the congressional directives and these powers are at their height when the Commission is fashioning a

remedy for a violation of the statute or an existing regulation. *Niagara Mohawk Power Co. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967). But while these powers may be available in appropriate cases, there is no need to test their scope here, where the regulatory obligations are voluntarily assumed.[22] Further, the condition only applies with regard to each of the individual types of transportation service offered and does not cover transportation under existing individual section 7 certificates or new individual section 7 certificates filed outside of the optional expedited certificate procedure.

Judicial recognition of the Commission's authority to impose the non-discriminatory access condition has already been indicated in the companion cases *Maryland Peoples Counsel v. FERC*, Nos. 84-1019 and 84-1090 (D.C. Cir. 1985). In those cases, the court vacated Columbia Transmission Company's special marketing program and the Commission's rule allowing pipeline transportation for certain industrial end-users. In both instances, the court found the Commission had not justified the programs to the extent they **[JA 357]** allowed pipelines to transport gas to some customers without requiring pipelines to furnish the same service to all customers on non-discriminatory terms.

In its order on the blanket certificate program (No. 84-1090), the court noted, *id*, at n.19, that MPC's plea that blanket transportation certificates be conditioned on non-discriminatory access accords with the recommendation of the Department of Energy: "To achieve the benefits of a properly developed spot market for natural gas . . . FERC should use its authority over natural gas transportation to require pipeline companies to provide carriage on a non-discriminatory basis whenever there is idle pipeline capacity." DOE Report, *supra*, p. 3, at 82. The court further noted that the Commission does not question that it has such authority, *citing Tennessee Gas Pipeline Co. v. FERC*, 689 F.2d 212, 214-15 (D.C. Cir.

1982); *Transcontinental Gas Pipe Line Corp. v. FERC*, 589 F.2d 186, 190 (5th Cir. 1979) (invoking "the well-established principle that generally the Commission has extremely broad authority to condition certificates of public convenience and necessity"), *cert. denied*, 445 U.S. 915 (1980).

Finally, we view section 311(c) of the NGPA as conferring sufficient authority to require a comparable condition under transactions authorized under that statute. The effect of NGPA section 602(b) is discussed below.

[JA 358]

b. *Authority to impose on interstate transportation by intrastate pipelines.*

Comments

Intrastate pipelines and state regulatory commissions cite the NGPA section 602(b) prohibition on common carrier status for section 311 transporters as an absolute ban on application of the non-discriminatory access condition to their operations.[23] They also state that the condition is illegal under NGPA section 601(a)(2)(A), which exempts transportation by intrastate pipelines under section 311(a) of the NGPA from Commission jurisdiction for purposes of section 1(b) of the NGA.[24]

These intrastate pipelines perceive the access conditions as a back door through which the Commission may intrude on their non-section 311, purely intrastate activities. They fear that the non-discriminatory access requirements ultimately will result, if they agree on any section 311 transportation, in more and more of their capacity being obligated to section 311 transportation. Consequently, they assert, the capacity available for intrastate activities would diminish, threatening their viability in the intrastate market. Further, the rate charged by a pipeline in each new section 311 trans-

portation arrangement would be subject to regulation by the Commission under the proposed rule. Therefore, intrastate pipelines, as well as many state regulatory agencies, view the non-discriminatory access condition as an indirect but substantial threat by the Commission to preempt state [JA 359] authority over intrastate pipeline activities. These commenters argue that the non-discriminatory access provision, therefore, violates NGPA sections 601(a)(2)(A) and 602(b).

Commission Response

The Commission has absolutely no intention of regulating intrastate transportaton of natural gas. Rather, the intent of the proposed rule was simply that the same non-discriminatory access condition should apply to all transportation in interstate commerce, whether by an entity subject to FERC jurisdiction under the NGA or to other entities allowed by the Commission under the NGPA to engage in such interstate commerce without becoming subject to the NGA.

Several changes have been made in the final rule to clarify this intent. First, there is no requirement that intrastate pipelines under section 311 provide such transportation service on a firm basis. See section 284.8(a)(ii). Firm transportation is not prohibited, however. In the event an intrastate pipeline offers firm transportation then section 284.8(b) requires that it provide "such" service on a non-discriminatory basis.

Similarly, if an intrastate pipeline offers interruptible interstate transportation (under section 284.(a)(ii)), the only obligation is to provide "such" interruptible service on a non-discriminatory basis. See section 284.9(b).

Thus, the final rule completely avoids the situation whereby an intrastate pipeline is required to offer firm service for out-of-state shippers, thus, progressively being turned into [JA 360] an interstate pipeline against

its will and against the will of the responsible state authorities.

With regard to the rate conditions of section 284.7, the proposed rule would have required intrastate pipelines to comply with the same conditions. The final rule makes it clear that the rate conditions of section 284.7 apply only to transportation under Subparts B, G and H and not to transportation by intrastate pipelines under Subpart C. The final rule retains the pre-existing rules regarding rates for Subpart C transportation. See section 284.123. In essence, there have been no real concerns with transportation by intrastate pipelines and therefore there is no need to modify the current rules.

With regard to the comment that the non-discriminatory access condition violates section 602(b), we note that the NGPA does not define "common carrier." Section 602(b) has scant legislative history. The only mention of the purpose of section 602(b) in the Conference Agreement merely states that the House bill had provided that "the intrastate pipeline would not have been subjected to regulation as a common carrier . . . ."[25] The Commission notes that Congress did not directly authorize section 311 transportation but gave the Commission the discretion to authorize such transportation under such terms and conditions as the Commission might prescribe under sections 311(c) and 501(a) of the NGPA.[26]

[JA 361]

All the Commission is doing here is ensuring that where a new entity enters into the field of offering interstate transportation services, that it do so on a non-discriminatory basis. We cannot accept the premise that section 602(b) is a Congressional license to "intrastate pipelines" to enter into the field of interstate commerce on an avowedly discriminatory basis. Whatever else the prohibition regarding "common carriage" status may do, it does not sweep so broadly as to license unduly dis-

criminatory rates or practices.[27] The same conclusion applies to interstate pipelines operating under section 311.

Further, it appears from the legislative history of the NGPA that the Commission's conditioning authority under NGPA sections 311(c) and 501(a) is coextensive with the broad discretion granted to the Commission under section 7(c) of the NGA.[28] Section 311(c) must be read in light of the fundamental intention of the NGPA to facilitate the movement of gas between the intrastate and interstate markets following a period of severe curtailment of interstate supplies coincident with ample intrastate supplies.[29]

Hence, the Commission has determined that the non-discriminatory access condition does not violate section 602(b).

The Commission emphasizes that it fully respects the bounds of its jurisdiction under section 1(b) of the NGA as reaffirmed by section 601(a)(2)(A) of the NGPA. The Commission does not intend that any aspect of the final rule intrude in any way whatsoever on the sound discretion of the states to regulate strictly [JA 362] intrastate transactions in the public interest. Nor does the Commission intend the final rule in any way whatsoever to impair the ability of intrastate pipelines to provide reliable service to their intrastate customers.

3. *The reasonableness of the non-discriminatory access condition.*

Comments

Some commenters complain that the non-discriminatory access condition is unreasonable, and therefore not authorized under law or otherwise appropriate, because it would interfere with pipelines' ability to make necessary and appropriate business decisions such as choosing a product/market mix of transportation and sales services, or declining to provide transportation services that would impair

their ability to meet their obligations to existing sales customers.[30] Intrastate pipelines state that the non-discriminatory access condition could potentially affect their ability to provide services in the intrastate market. Several commenters suggest that the harm to the reliability of existing services to pipeline customers would outweigh the benefits of the non-discriminatory access condition to new transportation customers.[31]

Some industrial end-users state that the imposition of the non-discriminatory access requirement on intrastate pipelines is unreasonable because most state agencies already have authority with respect to intrastate pipelines to accomplish the Commission's goal in proposing the condition. These commenters point to New [JA 363] Mexico and other states that have enacted or are considering statutes that require non-discriminatory gas transportation.

One industrial end-user, Air Products, argues that the Commission's proposal to apply the non-discriminatory access provision to intrastate pipelines would diminish the interstate-intrastate pipeline integration achieved since enactment of the NGPA. Lack of system integration would hinder the ability of interstate pipelines and their customers to gain access to reserves connected to intrastate pipelines. According to Air Products, the undesirable effects would result because intrastate pipelines would rather forego NGPA section 311 transportation altogether than expose all of their intrastate operations to possible Commission jurisdiction.

Other commenters, such as Oklahoma Natural Gas Company, suggest that the Commission revise the proposals to specifically limit application of the non-discrimination and firm transportation requirements to an intrastate pipeline's excess capacity in order to reassure intrastate pipelines and state regulatory agencies that the Commission will not intrude on local activities beyond its jurisdiction.

On the other hand, commenters supporting the non-discriminatory access condition assert that the condition is reasonable and absolutely necessary in order to ensure access, by pipeline customers and other shippers, to competitively priced gas supplies at the wellhead. They point to the proliferation of individual pipeline transportation programs and the expanded flexibility of [JA 364] the program proposed by the rule as direct benefits to pipelines which agree to the non-discriminatory access condition. Finally, they point to the history of pipeline gas purchasing practices over the last 30 years as justification for requiring pipelines who transport for others to do so on a non-discriminatory basis for all consumers.[32]

Commission Response

With regard to *intrastate* pipelines, we repeat what was stated above: intrastate pipelines are under no requirement to offer firm service under Subpart C, and the non-discriminatory access condition will apply only to the intrastate pipeline which provides "such" interruptible or firm service. Thus, where an intrastate pipeline offers only interruptible services, the access condition can in no way adversely affect its ability to provide firm service to intrastate customers.

With regard to *interstate* pipelines, the condition is also reasonable. First, the actual condition is voluntary. There is no requirement under the statutes or the rules that an interstate pipeline provide transportation under the self-implementing regulations. Moreover, the condition imposes, verbatim, the statutory ban against undue discrimination. The access condition, therefore, must be included in certificates and self-implementing transportation agreements in order to assure that gas supplies and transmission services are provided as broadly as possible in response to new demands from consumers and new competition in gas markets.

* * * *

EXCERPTS FROM ORDER NO. 436-A

[JA 1079]

The Commission considered most of the arguments raised by the applicants which suggest that the Commission lacks legal authority to apply the non-discriminatory access condition to interstate transportation under the NGA prior to issuing Order No. 436. Further, the Commission reviewed the requirements of the NGA, the legislative history of the NGA, and relevant case law.

Section 7(e) of the NGA, which was added as an amendment to the act in 1942, states, in pertinent part, that:

> The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

According to the Supreme Court:

> The Act was so framed as to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges . . .
>
> . . . In view of this framework in which the Commission is authorized and directed to act, the initial certification of a proposal under § 7(e) of the Act as being required by the public convenience and necessity becomes crucial. This is true because the delay incident to determination in § 5 proceedings through which initial certificated rates are reviewable appears nigh interminable.[30]

Thus, as stated by the Commission in Order No. 436 (at Section IV.A.), the Commission's certificate and con-

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[30] Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378, 388-89 (1959) (CATCO).

ditioning authority is the means by which it effectuates the purpose of the [JA 1080] NGA to underwrite just and reasonable rates to the consumers of natural gas.[31] Any attack on a condition in a certificate issued by the Commission must confront the well-established principle that generally the Commission has extremely broad authority to condition certificates of public convenience and necessity.

While determined to use the full breadth of its section 7 conditioning authority to end discriminatory transportation practices and thereby fulfill its obligation under sections 4 and 5, the Commission recognized that its actions could neither directly nor indirectly impose common carrier obligations on pipelines in violation of the NGA.[32]

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[31] *Id.* at 389.

[32] An important factor in the Commission's determination that it does not have the authority to mandate common carriage was the legislative history of sections 303 and 304 of Title III of H.R. 5423 which was introduced on February 6, 1935, (74th Congress 1st Session) by Representative Sam Rayburn, Chairman of the House Committee on Interstate and Foreign Commerce.

Sections 303 and 304 of H.R. 5423 provided in pertinent part (emphasis added):

> Section 303(a). *It shall be the duty of every distributor to* furnish natural gas, to exchange natural gas with, and *transmit natural gas for any person* upon reasonable request therefor; and to furnish and maintain such services and facilities as shall promote the customers, employees, and the public, and shall be in all respects adequate, efficient and reasonable . . .
>
> Section 304. Whenever the Commission after notice and opportunity for hearing finds such action necessary or desirable in the public interest, *it may by order direct a distributor* to make additions, extensions, repairs, or improvements to or changes in its facilities, to establish physical connection with the facilities of one or more persons, to permit use of its facilities by one or more persons, or utilize the facilities of, sell natural gas to, purchase natural gas from, *transmit natural gas for,* or exchange natural gas with *one or more other persons* . . .
> . . . [T]he Commission may prescribe the terms and conditions

Further, the condition only applies with regard to each of the individual types of Order No. 436 transportation service offered. Therefore, for example, an interstate pipeline may transport under the Part 284, Subpart G blanket certificate program without becoming subject, by reason of such blanket certificate transportation, to an obligation to provide service under Subpart B of Part 284 and [JA 1081] vice versa. Further, the non-discriminatory access provisions of §§ 284.8(b) and 284.9(b) *per se* do not cover transportation under existing individual section 7 certificates or new individual section 7 certificates filed outside of the optional expedited certificate procedure.

The Commission agrees with those petitioners that state that the court's mandate in *Maryland People's Counsel v. FERC*, 761 F.2d 768 and 768 F.2d 780 (D.C. Cir. 1985), was not intended to require that the Commission adopt mandatory carriage regulations. In any event, the Court's mandate clearly did judicially recognize all that is necessary for present purposes, that is the Commission [JA 1082] has the authority to impose non-discriminatory access conditions on pipeline transportation.[33]

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of the arrangement to be made between such persons, including the apportionment of reimbursement reasonably due to any of them.

Section 303 and 304 must be read in the context of sections 4(b) and 5(a) of the NGA as enacted. In contrast to the affirmative duty of unenacted section 303 of H.R. 4523, section 4(b) of the NGA flatly prohibits "any undue preference or advantage" and "any reasonable difference" in service or as between classes of service. In contrast to the discretionary proposed authority in unenacted section 304 of H.R. 5423 to *order* transportation, section 5(a) of the NGA contains *no express authority to order transportation.* Instead, section 5 limits the Commission to fixing prospectively by order the "just and reasonable . . . rule, regulation, practice or contract" to be observed.

[33] In its order on the blanket certificate program (No. 84-1090), the court noted (761 F.2d at 789 n.19) that MPC's plea that blanket transportation certificates be conditioned on non-discriminatory

The Commission determined that the non-discriminatory access conditions in Order No. 436 did not amount to a "direction" or a "mandate" to pipelines to transport for others as an "affirmative [JA 1083] duty" because the condition is only a condition. As it stated in the order: "a *condition* on the certification or authorization of certain self-implementing transportation services which a pipeline may *voluntarily choose to perform or not*, strictly at its own option." Thus, Order No. 436 does not "direct" or 'mandate" a pineline to do anything. Further, the non-discriminatory access condition, even when accepted by a pipeline as part of its self-implementing transportation program, does not impose any "affirmative duty" on a pipeline to transport. It only requires that when a pipeline *does* choose to transport on a self-implementing basis, it must provide those transportation services in a non-discriminatory manner. Nor does the condition cover all transportation services and thus operate as mandatory *in effect*. A pipeline remains free to seek authorization for other transportation not covered by the condition and the Commission will review them on a case-by-case basis.[34]

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access accords with the recommendation of the Department of Energy: "To achieve the benefits of a properly developed spot market for natural gas . . . FERC should use its authority over natural gas transportation to require pipeline companies to provide carriage on a non-discriminatory basis whenever there is idle pipeline capacity." Second DOE Section 123 Report at p. 82. The court further noted that the Commission does not question that it has such authority, *citing* Tennessee Gas Pipeline Co. v. FERC, 680 F.2d 212, 214-15 (D.C. Cir. 1982); Transcontinental Gas Pipeline Corp. v. FERC, 589 F.2d 186, 190 (5th Cir. 1979) (invoking "the well-established principle that generally the Commission has extremely broad authority to condition certificates of public convenience and necessity"), *cert. denied*, 445 U.S. 915 (1980).

[34] Several petitioners argue that Order No. 436 is similar to regulatory programs rejected by the courts in Moss v. CAB, 430 F.2d 891 (D.C. Cir. 1970) and Consolidated Edison Company of New York v. FPC, 511 F.2d 372, 377 (D.C. Cir. 1974). The Com-

[JA 1084]

Furthermore, the Commission is not dissuaded by the comparisons made by several petitioners including, e.g., NGPL (at pp. 12, 28) and City of Willcox, Arizona (at p. 35), between Order No. 436 and the legislative proposals to mandate common-carriage transportation that have been considered, but not enacted by Congress over the years. Nor does the Commission believe that Order No. 436 is inconsistent with section 602(b)(2) of the NGPA, which provides that no person shall be subject to regulation as a common carrier by reason of any transportation authorized under section 311(a) of the NGPA. In the first place, the Commission notes that neither the NGA nor the NGPA defines "common carrier." Nevertheless, the provisions of Order No. 436 do not regulate pipelines as common carriers, as that term is commonly understood.[35]

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mission does not believe these cases are germane in this instance. In *Moss* the Civil Aeronautics Board failed to comply with the public notice and hearing requirements of the Federal Aviation Act in prescribing a fare formula for domestic airlines. Moreover, the court found that the formula actually amounted to a prescription of rates, because the Board admitted that the pressures on carriers to file conforming rates was "great if not irresistable." In a similar vein, the court held in *Consolidated Edison* that if end-use curtailment plans were not filed voluntarily by pipelines but were the result of coercion by the Federal Power Commission the plans would be invalid, because the Commission could not impose a change on an existing tariff without complying with section 5 of the Natural Gas Act.

Neither of these cases applies to the circumstances of Order No. 436. In the first place, Order No. 436 was issued in compliance with applicable rulemaking procedures, which involved extensive public participation. Moreover, as the Commission has already explained, the self-implementing transportation program is voluntary and indeed alternative authority is fully available under traditional Natural Gas Act procedures.

[35] Since Order No. 436 does not have the effect of imposing common carriage status on contract carriers, cases cited for the

[JA 1085]

For instance, even though Order No. 436 requires, as the cited legislative proposals would have required, nondiscriminatory access, the all-important distinction is that Order No. 436 allows a pipeline the option of applying to provide transportation services under individual NGA section 7 certificates. Order No. 436 also gives a pipeline that has opted for self-implementing transportation the opportunity to cease such transportation and resume its status as a merchant. None of the mandatory common-carriage proposals considered heretofore by Congress have included any equivalent option. While a transportation application under the regular NGA section 7 procedures is open to challenge on the grounds that approval of the application would result in undue discrimination, only the individual transportation arrangement covered by the pipeline's applications is at issue in a regular NGA section 7 certificate proceeding and, therefore, denial of a certificate in that proceeding does not prejudice certificate applications by the same pipeline in other proceedings. This option, unlike the legislative proposals for common-carriage, effectively allows a pipeline the discretion to determine whether or not to become a transporter of gas. Further, while allegations of unduly discriminatory effects will be considered in regular NGA section 7 transportation certificate proceedings, a regular NGA certificate is not conditioned on a pipeline's providing transportation to all shippers requesting service. For example, if the Commission should determine that approval of a regular NGA section 7 transportation certificate application would cause undue [JA 1086] discrimination to another party, the discrimination could be cured by an amendment to the application as it affects a particular additional shipper.

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proposition that only Congress can impose that status (FCC v. Midwest Video Corp., 440 U.S. 689, 702-09 (1978) and Florida Power and Light Co. v. FERC, 660 F.2d 668 (5th Cir. 1981) are not applicable.

The Commission cannot agree with those applicants that insist that it is not unduly discriminatory for a pipeline that transports gas to refuse to transport gas that displaces the pipeline's sales. This is precisely what the court found objectionable in *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir., 1985). Pipelines that were willing to transport gas for their fuel-switchable customers were not required to transport for their captive sales customers that were incapable of switching fuels.

2. *Effects of Non-Discriminatory Access*

a. *On Order No. 319 Transactions*

Certain of the applications for rehearing request that the Commission amend the final rule to allow new transactions to provide transportation for local distribution companies and high-priority end users, previously authorized under NGPA § 311 and Order Nos. 319 and 60, to continue to be made without requiring interstate pipeline companies to provide non-discriminatory access. Philadelphia (passim), CIG (at pp. 25-28) and BUG (at pp. 3-8) assert that the access condition is inconsistent with the NGPA and is not required by the *Maryland People's Counsel* decisions of the D.C. Court of Appeals. Huffco (at pp. 17-18) contends that certificates for the transportation of gas to high-priority end users are required to be issued by section 7(c)(2) of the NGA.

[JA 1087]

Existing transportation for high-priority end users that had been authorized under § 157.209(a) of the regulations has been permitted to continue for the term of the transportation arrangement, subject to the terms and conditions existing at the time it was authorized. *See* § 284.223(g). New high-priority end-user transportation, section 311 transportation for intrastate pipelines and local distribution companies, transportation for end users

under § 157.209(e), and transportation for interstate pipelines, are subject to the express requirement that the transporting pipeline provide non-discriminatory access for all shippers and the various other requirements of § 284.7 *et seq.* The Commission has determined that the practice of restricting access to transportation is unduly discriminatory and preferential and has prevented consumers from obtaining the lowest reasonable rates for both gas and transmission. With that determination, and in view of the many other reasons expressed in the final rule for requiring open access for future transportation, it would be inconsistent with the whole rationale underlying the final rule (and, in the Commission's view, with the rationale underlying the *Maryland People's Counsel* cases as well) to permit new transactions to be initiated for service without adherence to the requirements of the final rule.

* * * *

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Nos. 87-978, 87-1091

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

SHELL OFFSHORE, INC., *et al.*,
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v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF IN OPPOSITION OF TENNESSEE GAS PIPELINE COMPANY

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF THE CASE	2
REASONS WHY THE WRITS SHOULD NOT BE GRANTED	7
I. THE PRODUCERS' PETITION IS NOT RIPE FOR REVIEW	7
II. THE COURT OF APPEALS PROPERLY REMANDED THE PROCEEDING TO THE COMMISSION FOR FURTHER CONSIDERATION	11
A. The Court of Appeals Correctly Affirmed the Commission's Authority Under the Natural Gas Act to Remove Barriers That Prevent the Efficient Functioning of Gas Markets	12
1. The Commission Has Plenary Jurisdiction Over The Transportation of Natural Gas	12
2. The NGPA Does Not Bar The Commission's Exercise Of its Authority To Modify Non-Price Terms In Jurisdictional Contracts	15
B. In Remanding The Case To The Commission The Court Of Appeals Correctly Applied The Arbitrary-And-Capricious Test	
III. THE COURT SHOULD NOT RENDER AN ADVISORY OPINION ON THE SCOPE OF THE STATES' JURISDICTION OVER THE INTERSTATE TRANSPORTATION OF NATURAL GAS	19
CONCLUSION	22

TABLE OF AUTHORITIES

CASES: Page

Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987) ..... *passim*
Brotherhood of Locomotive Firemen v. Bangor & Aroostook Railroad Co., 389 U.S. 327 (1967) 8-9
Chevron, U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984) 9, 16
Conway Corp. v. FPC, 510 F.2d 1264 (D.C. Cir. 1975), affirmed, 426 U.S. 271 (1976) 16
FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972) 13
FPC v. East Ohio Gas Co., 338 U.S. 464 (1950) 13
Hamilton-Brown Shoe Co. v. Wolf Brothers & Co., 240 U.S. 251 (1916) 9
International Longshoreman's and Warehouseman's Union, Local 37 v. Boyd, 347 U.S. 222 (1954) 21
Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983) 17, 18
Office of Consumers' Counsel v. FERC, 783 F.2d 206 (D.C. Cir. 1986) 15-16
Olson v. Paine, Webber, Jackson & Curtis, Inc., 806 F.2d 731 (7th Cir. 1986) 8
Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm., 341 U.S. 329 (1951) .....
Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) 15
United Gas Pipe Line Co. v. FERC, 597 F.2d 581, 588 (5th Cir. 1979), *cert. denied*, 445 U.S. 916 (1980) 2-3
Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1148 (1986) .. 5

FERC ORDERS AND DECISIONS:

Amoco Production Co., 23 F.E.R.C. (CCH) ¶ 61,211 (1983) 3

TABLE OF AUTHORITIES—Continued

Page

Impact of Special Marketing Programs on Natural Gas Companies and Consumers, Notice of Inquiry, 49 Fed. Reg. 3193, F.E.R.C. Stats. & Regs. (CCH) ¶ 35,513 (1984) 3, 4

Mojave Pipeline Co., 35 F.E.R.C. (CCH) ¶ 61,199 (1986), *rehearing denied*, 41 F.E.R.C. (CCH) ¶ 61,040 (1987), *appeal pending*, Public Utilities Comm. of California v. FERC, No. 87-1679 (D.C. Cir.) 21

Order Explaining Crediting Provisions, 41 F.E.R.C. (CCH) ¶ 61,025 (1987) 8

Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Notice of Proposed Rulemaking, 50 Fed. Reg. 24,130 (1985), [1982-1987 Proposed Regs. Transfer Binder] F.E.R.C. Stats. and Regs. (CCH) ¶ 33,100 (1985) 2

Regulation of Natural Gas Pipeline After Partial Wellhead Decontrol (Order No. 500), Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (August 14, 1987) III F.E.R.C. Stats. & Regs. [Reg. Preambles] (CCH) ¶ 30,761 (1987) 7, 8, 10, 11

Tenneco Oil Co., 29 F.E.R.C. (CCH) ¶ 61,334 (1984) 14

Tenneco Oil Co., 26 F.E.R.C. (CCH) ¶ 61,030 (1984) 14

STATUTES AND REGULATIONS:

Natural Gas Act of 1938;

Section 1(b), 15 U.S.C. § 717(b) 13
Section 5, 15 U.S.C. § 717d ..... *passim*
Section 7, 15 U.S.C. § 717f ..... *passim*

Natural Gas Policy Act of 1978;

Section 311, 15 U.S.C. § 3371 ..... 12, 13
Section 311(c), 15 U.S.C. § 3371(c) 13
Section 601(a)(1), 15 U.S.C. § 3431(a)(1) ... 15
Section 601(a)(2), 15 U.S.C. § 3432(a)(2) 13
Section 601(c)(1), 15 U.S.C. § 3431(c)(1) ... 13-14

TABLE OF AUTHORITIES—Continued

LEGISLATIVE AUTHORITIES: Page

Hearings before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. (October, 1983) 4

124 Cong. Rec. H 13119 (October 14, 1978) 13

ARTICLES:

Foster's Natural Gas Reports, Feb. 25, 1988 5

Williams, The Proposed Sea-Changes In Natural Gas Regulation, 6 Energy L. J. 233, 237 (1985) 3

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BRIEF IN OPPOSITION OF TENNESSEE GAS PIPELINE COMPANY

Five petitions for writs of certiorari seek review of discrete aspects of *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (*AGD*). In No. 87-978, *Shell Offshore, Inc. v. FERC*, certain producers of natural gas ("Producers") jointly seek reversal of the court of appeals' remand for reconsideration of the Commission's refusal in FERC Order No. 436 to mitigate the impact on interstate pipelines' take-or-pay liabilities of requiring such pipelines to transport gas, as open-access carriers,

that displaces pipeline sales. Tennessee Gas Pipeline Company (Tennessee) opposes this petition.[1]

In No. 87-1091, *Southern California Gas Co. v. FERC*, a local distribution company (SoCal) seeks review of that portion of *AGD* that upholds alternative procedures adopted in Order No. 436 to expedite the approval of applications for certificates under section 7 of the Natural Gas Act (NGA), 15 U.S.C. § 717f, to provide new services and construct new facilities. Tennessee opposes SoCal's petition insofar as it requests an advisory opinion on the line of demarcation between interstate transportation of natural gas subject to the Commission's NGA jurisdiction and the local distribution of natural gas subject to regulation by the states.

STATEMENT OF THE CASE

Take-or-pay provisions in gas supply contracts between interstate pipelines and producers of natural gas have led to serious "market disorders" in the natural gas industry since the enactment of the Natural Gas Policy Act (NGPA) in 1978.[2] Between 1978 and 1982, interstate gas pipelines, emerging from the severe shortages and curtailments of the 1970's, contracted for available gas reserves to meet customer requirements and replenish declining inventories.[3] Because the demand for

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[1] Tennessee Gas Pipeline Company is a wholly-owned subsidiary of Tenneco Inc. Throughout this brief, references to the Appendix in No. [illegible]-978 are cited as App. ——. Emphasis is supplied throughout this brief unless otherwise noted.

[2] The Commission so found when it initiated the rulemaking which led to the promulgation of Order No. 436. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Notice of Proposed Rulemaking, 50 Fed. Reg. 24,130 (1985), [1982-1987 Proposed Regs. Transfer Binder] F.E.R.C. Stats. and Regs. (CCH) ¶ 33,100 at 33,105-06 (1985).

[3] The Commission requires that pipelines maintain adequate supplies to meet their service obligations reflected in certificates issued pursuant to § 7 of the NGA. *See, e.g.*, United Gas Pipe Line Co.

reserves far exceeded supply, such reserves commanded the maximum lawful prices allowed by the NGPA for price-regulated gas and still higher prices for deregulated gas. Producers also typically obtained onerous quantity provisions, which obligated their pipeline-purchasers to take, or pay for, a very high percentage (typically 75 percent to 95 percent) of the producer's delivery capability. Interstate pipelines had no choice but to accept these burdensome terms in order to meet their contractual and certificated sales obligations to their customers:

> *All* the interstate pipelines bid supra-market prices for gas in 1978-82. A natural question is what would have happened to a pipeline that refused to do so. The answer is—Disaster. Any pipeline that limited its bids to true market prices would have found itself short of gas and almost certainly in breach of both contractual and regulatory duties to supply gas. With rolled-in prices and the NGPA system of wellhead price controls, it was a mathematical *necessity*, for the natural gas market to clear, that some gas be bought at prices above market levels.

Williams, *The Proposed Sea-Changes In Natural Gas Regulation*, 6 Energy L. J. 233, 237 (1985) (emphasis in original).

Since 1982, however, the gas market has moved from shortage to surplus. The Commission has traced the surplus to a decline in consumption caused by conservation, recession, loss of heavy manufacturing, fuel switching (due to the collapse of world oil prices)[4] and

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v. FERC, 597 F.2d 581, 588 (5th Cir. 1979), *cert. denied*, 445 U.S. 916 (1980); Amoco Production Co., 23 F.E.R.C. (CCH) ¶ 61,211 at 61,433 (1983).

[4] *See* Impact of Special Marketing Programs on Natural Gas Companies and Consumers, Notice of Inquiry, 49 Fed. Reg. 3193, IV F.E.R.C. Stats. & Regs. (CCH) ¶ 35,513 (1984).

a substantial increase in deliverability from existing reserves.[5] This surplus gas became available on the "spot market" at prices below the average cost of pipeline system supply under long-term contract. Order No. 436 allows producers to channel their uncommitted, surplus gas into pipeline sales markets at reduced prices. At the same time, producers demand that pipelines pay for gas that the pipelines are unable to take under existing higher-priced long-term contracts because the market has been displaced by the producers' lower-priced, surplus gas. Thus, Order No. 436 creates unprecedented, multi-billion dollar take-or-pay problems for interstate pipelines.[6] Therein lies the rub.

Order No. 436 restructures the natural gas industry by forcing interstate pipelines to become "open access" transporters of gas sold by producers to local distribution companies (LDCs) and end-users who previously relied almost exclusively on interstate pipelines for their gas supply.[7] However, Order No. 436 did not relieve inter-

[5] The NGPA particularly spurred developmental drilling (that is, the drilling of new wells on existing reserves to increase production) rather than exploratory drilling for new reserves. *See* Notice of Inquiry, n.4, *supra*. For example, between 1978 and 1983, Transcontinental Gas Pipe Line Corporation's dedicated reserves increased by 3 percent, while deliverability under its supply contracts increased 140 percent. Hearings before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. (October, 1983) (Statement of Brian O'Neill).

[6] Estimates of accrued take-or-pay in 1985 were approximately $7 billion. App. at 75a. Producers assert that Order No. 436 is resolving the problem. (Pet. Br. at 20) However, producers own figures underscore the severity of the problem. Despite having paid producers $200 million in 1985 and $700 million in 1986 plus non-cash concessions, pipelines continue to incur over $6 billion dollars of additional take-or-pay annually. The $700 million is just the tip of the iceberg.

[7] See the petitioners' statements of the case in Interstate Natural Gas Assoc. v. FERC, No. 87-976; Texas Eastern Transmission Corp. v. FERC, No. 87-977; and City of Willcox v. FERC, No. 87-979. These petitions seek review of the Order No. 436 open-access provi-

state pipelines of their traditional merchant role. Because of the Commission's concern for security of supply, pipelines are required to maintain a sufficient supply of gas to meet their certificated service obligations to their customers.[8] This, in turn, requires pipelines to maintain their long-term contracts with gas producers which contain provisions that obligate pipelines to pay for certain minimum volumes of gas whether or not taken. Pipeline customers, however, no longer are obligated to purchase a minimum amount of gas from their pipeline suppliers.[9] Thus, as explained previously, Order No. 436 allows producers to sell surplus "spot market" gas and other uncommitted supplies to pipeline customers while requiring pipelines to take or pay for long-term gas purchased to serve the same customers. Under current surplus conditions, producers have successfully displaced pipeline sales with spot market gas. Published reports estimate that nearly 70 percent of interstate gas transmission is transportation of gas for others rather than pipeline sales.[10]

In Order No. 436, the Commission refused to adopt affirmative remedies to mitigate the build-up of take-or-pay liability under producer-pipeline gas supply contracts caused by its open access transportation program. The Commission told pipelines to buy their way out of their obligations to producers and attempt to pass these payments downstream to their ratepayers in individual rate cases. *See* App. at 80a-85a. In so doing, the Commission

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sion on the ground that it reflects the unlawful imposition of common carriage on interstate pipelines.

[8] *See* the discussion at n.3, *supra*. Pipelines earn no profit on their gas inventories; they are required to resell their gas at cost.

[9] *See* Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1148 (1986) (affirming FERC Order No. 380, which required interstate pipelines to eliminate gas cost minimum bills from their rate schedules).

[10] Foster's Natural Gas Reports, Feb. 25, 1988 at 15.

made no real assessment of pipelines' abilities to arrange such buy-outs, the aggregate cost of pipelines' buying out of these obligations, the effect of such buy-outs on LDC supply security and the rate impact on ultimate consumers. Moreover, Order No. 436 removed the pipelines' principal bargaining chip to mitigate the cost of resolving take-or-pay problems—the ability to trade transportation for renegotiation of "problem" contracts. *See* App. at 81a.

On review of Order No. 436 in *AGD*, the court of appeals upheld the Commission's authority to impose open-access, common carriage obligations on interstate pipelines. However, it found that the Commission's treatment of the take-or-pay issue did not meet the requirement of "reasoned decisionmaking." The court of appeals identified the three premises upon which the Commission's refusal to act was based: (1) Order No. 436 would not cause take-or-pay liabilities to increase; (2) certain policy considerations militated against regulatory relief; and (3) the most obvious remedies (exercise of NGA § 5 power to modify unjust and unreasonable take-or-pay provisions, and limitations on open access with respect to producers that refused to cooperate in mitigating the impact of Order No. 436 on pipeline take-or-pay) were flawed. App. at 80a. It remanded Order No. 436 because the first and third premises were insupportable.

The court of appeals explained in great detail why it could not accept the Commission's assertion that Order No. 436 would not increase pipeline take-or-pay exposure and make it more difficult and expensive for pipelines to resolve these liabilities. App. at 80a-86a. It concluded that "FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability . . . seem[s] impossible to square with the requirement of reasoned decisionmaking. App. at 84a.

The court of appeals also found fatal weaknesses in the reasons offered by the Commission for rejecting the

major alternatives supported by virtually all state regulatory agency and LDC representatives. App. at 89a-94a. The court found the Commission's explanation of its rejection of section 5 action to be so unclear that meaningful review was impossible. App. at 90a. The court similarly found wholly implausible the Commission's assertion that any limitation on open access would be unduly discriminatory under the NGA. App. at 91a-92a. Thus, it remanded the case to the Commission for further explanation. App. at 124a.

REASONS WHY THE WRITS SHOULD NOT BE GRANTED

I. THE PRODUCERS' PETITION IS NOT RIPE FOR REVIEW

To be sure, Order No. 436 is of enormous significance to all segments of the natural gas industry. But that does not mean that all of the petitions raise issues that are worthy of review by this Court. Producers' petition differs sharply from the Interstate Pipeline petitions (cited in note 7) in its fitness for review by the Court. The open access regulations challenged by the Interstate Pipelines are final and in effect; their legality has been determined subject only to review by this Court.[11] By contrast, the court of appeals did not finally determine that the Commission was required to adopt specific take-or-pay mitigating measures as part of the restructuring of its regulation of natural gas companies. The majority opinion stressed repeatedly that it was not ordering the Commission to adopt a particular

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[11] In *AGD*, the court of appeals upheld the open access requirement of Order No. 436 pipelines, and the Commission has repromulgated this requirement intact. FERC Order No. 500, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (August 14, 1987), III. F.E.R.C. Stats. & Regs. [Regs. Preambles] (CCH) ¶ 30,761 (1987).

remedy.[12] Rather, it was remanding because the Commission did not express its reasons "clearly enough for [the court of appeals] to determine the legality of its analysis." App. at 90a.

The Commission has not dissented from this course; it has not asked this Court to review the decision below or to relieve it from the judgment. To the contrary, it has instituted a new proceeding in which it intends to examine fully the extent of the take-or-pay problem and explore the need for additional Commission action.[13] It also has issued *interim* regulations that attempt in a limited way to restore the pre-Order No. 436 *status quo* insofar as take-or-pay build-up is concerned.[14] Under the circumstances, review of this aspect of the *AGD* decision below is unwarranted.

In light of the strong judicial policy against piecemeal review[15], the Court does not grant certiorari to review a non-final judgment such as a remand order in the absence of special circumstances that require the Court to intercede. *See Brotherhood of Locomotive Firemen v.*

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[12] App. at 90a, 92a, 94a and 124(a) ("We do not require that FERC reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking." App. at 94a).

[13] As part of Order No. 500, *supra*, n.11, the Commission invited public comments on a range of permanent options to address the take-or-pay impact of open access transportation, and stated that it would use its statutory authority to collect comprehensive data on take-or-pay. F.E.R.C. Stats. & Regs. (CCH), *supra*, at 30,784, 30,799-800. The Producers have been and doubtless will continue to be active participants in that proceeding.

[14] The FERC Order No. 500 regulations provide, as an interim measure, that producers give open access pipelines volumetric credit against take-or-pay obligations for each Mcf of gas transported for that producer. *See* Order No. 500, *supra*, n. 11; Order Explaining Crediting Provisions, 41 F.E.R.C. (CCH) ¶ 61,025 (1987).

[15] *See, e.g.*, Olson v. Paine, Webber, Jackson & Curtis, Inc., 806 F.2d 731, 733 (7th Cir. 1986).

Bangor & Aroostook Railroad Co., 389 U.S. 327, 328 (1967); *Hamilton-Brown Shoe Co. v. Wolf Brothers & Co.*, 240 U.S. 251, 258 (1916). No special circumstances warrant review of the court of appeals' remand on the take-or-pay issue. The facts and circumstances strongly counsel against premature review of the remand order.

First, Producers' petition does not challenge the legality of specific regulations or decisions of the Commission. Instead, Producers request the Court to issue an advisory opinion that the Commission has no authority whatsoever to mitigate the build up of take-or-pay caused by open access transportation under Order No. 436.[16]

Producers' legal challenge lacks the concreteness necessary for review by the Court.[17] For example, the court of appeals discussed generically, under the heading "conditioning producer access", proposals for mitigation of take-or-pay, which differed in their specific elements. App. at 91a. Some requested no more than a declaration by the Commission that it is not unduly discriminatory *per se* for an open access pipeline to negotiate and obtain take-or-pay credit equal to the quantity of gas that a producer wants to sell and have transported to the pipeline's tradi-

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[16] The Commission has not defended Order No. 436 on the ground that it lacked authority to take affirmative action to mitigate the take-or-pay problem. Although it suggested at one time that it might not have authority, it moved away from that position on rehearing and repudiated it in its brief to the court of appeals. App. at 93a. Thus, Producers objections at pages 9-15 of their petition go to the court of appeals' rejection of their attempt to support the Commission's order on grounds that the Commission did not rely on for its decision.

[17] The Court's opinion in Chevron, U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984), presumes that the agency will have provided an explication of its statutory authority in the first instance. Because of the context in which Producers' challenge arises, the Court does not have the benefit of an in-depth analysis by the Commission of its statutory authority to mitigate the impact of Order No. 436 on interstate pipelines.

tional sales customers. Others would have required producers to renegotiate above-market "problem contracts" with all interstate pipelines in order to obtain open access transportation on any pipeline's system. Obviously, these proposals would have very different impacts on the affected parties and implicate different values. Yet, Producers would have the Court condemn all possible actions by the Commission that might affect producer contracts without any consideration of the qualitative and quantitative difference of various proposals. If, on remand from the decision below, the Commission adopts final rules that adversely affect producer interests, they will have a full opportunity to contest the legality of the case-specific actions.[18]

Second, the outcome of the Commission proceedings on remand is hardly a foregone conclusion, and may eliminate Court review. In Order No. 500, the Commission did not exercise its authority under section 5 of the NGA to modify jurisdictional producer-pipeline contracts; nor did it broadly order producers to abrogate their above-market contracts or lower their prices under such contracts. The Commission adopted a limited, temporary remedy *pendente lite*. *See* FERC Order No. 500, *supra*, n. 11. Producers have filed comments in that proceeding which challenge the legality and wisdom of take-or-pay crediting, and the Commission has the matter under advisement.

Third, regardless of the outcome of the Commission's proceeding on remand, further judicial review will be based upon a far more complete record than the patently inadequate record in the Order No. 436 proceeding. The court of appeals rightly described the Commission's fac-

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[18] Several of the petitioners in No. 87-978 have appealed the interim take-or-pay crediting procedures of FERC Order No. 500 to the United States Court of Appeals for the Fifth Circuit. That proceeding provides an additional forum in which to contest in a concrete setting the Commission's exercise of its NGA jurisdiction.

tual assessment to be "utterly Panglossian." [19] After promulgating Order No. 436, the Commission admitted to Congress that it did not have the data to assess the extent of the existing take-or-pay problem.[20] On remand, the Commission has exercised its authority under the NGA and the NGPA to obtain data on the extent of the take-or-pay problem.[21] Correction of this glaring omission can only aid the administrative and judicial process.

II. THE COURT OF APPEALS PROPERLY REMANDED THE PROCEEDING TO THE COMMISSION FOR FURTHER CONSIDERATION

In light of our strongly held belief that review by this Court is premature, we ordinarily would not address the question whether the remand order was correct on the

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[19] App. at 94a. *See* App. at 81a-84a ("FERC offers nothing to undermine the challengers' inherently plausible suggestion that [the Order No. 436 open access] conditions will have an adverse impact on the pipelines' take-or-pay problems.")

[20] In April, 1986, the Commission admitted in a letter to members of the Government Operations Committee of the House of Representatives, that it had very little idea of the extent to which pipeline operations had been or would be affected by actual or potential take-or-pay liability. The Commission stated that data submitted under current regulations "do not provide sufficient information to assess the current magnitude of these [take-or-pay] liabilities." The Members asked whether the Commission had solicited data with respect to take-or-pay obligations in the rulemaking and whether it had data to assess the extent to which Order No. 436 would increase pipelines' take-or-pay exposure. The Commission answered, "there are no data on the extent to which Order No. 436 may increase pipeline take-or-pay exposure." This letter is reprinted in the Supplemental Appendix to this brief.

[21] In FERC Order No. 500, *supra*, n.11, the Commission announced it was requiring each interstate natural gas pipeline company to respond to an extremely detailed data request "to determine the extent and nature of pipelines' take-or-pay obligations with respect to the various NGPA pricing categories." The Commission stated that it would "aggregate the data and analyze it promptly." F.E.R.C. Stats. & Regs. (CCH) at 30,784.

merits. However, Producers' petition could be construed to argue that the decision below is so obviously wrong that further proceedings are clearly unnecessary. We, therefore, demonstrate below that the court of appeals' decision is well grounded in law and policy.

A. The Court of Appeals Correctly Affirmed the Commission's Authority Under the Natural Gas Act to Remove Barriers That Prevent the Efficient Functioning of Gas Markets

Producers argue that the *AGD* decision unjustifiably authorizes the Commission to deny "access to transportation for many producers. . . ." (Pet. Br. at 10) However, neither the NGPA nor the NGA mandate that interstate pipelines must transport gas sold by producers to pipeline sales customers in transactions that displace pipelines' sales and create take-or-pay liability. App. at 93a-94a. In Order No. 436, the Commission mandated open access as an exercise of its power to condition the authority of pipelines to transport gas under section 7 of the Natural Gas Act, 15 U.S.C. § 717e, and section 311 of the Natural Gas Policy Act, 15 U.S.C. § 3371. If the Commission's NGA and NGPA powers allow it to impose open access conditions on interstate pipelines,[22] then the Commission similarly may place qualifications on open access as a transitional measure to mitigate the build-up of take-or-pay costs and encourage the renegotiation of such barriers to the efficient operation of gas markets.

1. *The Commission Has Plenary Jurisdiction Over The Transportation of Natural Gas*

Although the NGPA withdrew the Commission's authority to establish wellhead prices and to regulate so-called "first sales" of natural gas, it reaffirmed the Commission's plenary jurisdiction over the *transportation* of

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[22] Nos. 87-976, 87-977 and 87-979 seek Court review of the legality of the open access requirement.

natural gas pursuant to sections 1(b) and 7 of the NGA, 15 U.S.C. §§ 717(b), 717f, and section 311 of the NGPA, 15 U.S.C. § 3371.[23]

Any doubt as to the Commission's continuing plenary jurisdiction over interstate transportation is dispelled by the legislative history of the NGPA. The Explanatory Statement of the House Managers of the conference bill that became the NGPA emphasizes that:

> FERC retains its transportation certification authority under section 7 of the Natural Gas Act. The authority was relied upon by both FERC and its predecessor, the FPC, to impose a wide range of conditions upon the transportation of gas in interstate commerce. This authority remains intact . . . .[24]

Producers claim that the court of appeals ignored the limitations placed on the Commission's transportation jurisdiction by section 601(c)(1) of the NGPA, 15 U.S.C.

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[23] Section 1(b) of the NGA gives the Commission jurisdiction over (1) the transportation of natural gas in interstate commerce, (2) the sale for resale of natural gas in interstate commerce and (3) natural gas companies engaged in such sales or transportation. Each of these grants in an independent, albeit often overlapping fount of authority. FPC v. Louisiana Power & Light Co., 406 U.S. 621, 636 (1972); FPC v. East Ohio Gas Co., 338 U.S. 464, 468-69 (1950). In integrating the NGPA with the NGA, Congress actually expanded the Commission's jurisdiction over gas transportation. Pursuant to NGPA § 601(a)(2), 15 U.S.C. § 3431(a)(2), the Commission's *NGA* transportation jurisdiction was modified only with respect to the extraordinary presidential authority contained in NGPA §§ 302 and 303 and to acknowledge the additional grant of authority in NGPA § 311 over certain transportation by intrastate and interstate pipelines. Notably, § 311(c), in virtually the same terms as NGA § 7(e), authorizes the FERC to approve qualifying transportation arrangements "under such terms and conditions as the Commission may prescribe." 15 U.S.C. § 3371(c).

[24] 124 Cong. Rec. H13119. Notably, in their brief to the court of appeals (at 20), Producers described the Explanatory Statement as the "strongest type of legislative interpretation."

§ 3431(c)(1).[25] However, producers did *not* argue below that Section 601(c)(1) placed substantive limits on the Commission's authority to mitigate the impact of Order No. 436 on pipeline take or pay. Section 601(c)(1) is irrelevant to the access condition considered in *AGD*. By imposing an access condition, the *Commission* would *not* be denying any pipeline the right to apply for and receive a certificate to transport for any person "based upon the amount paid in any sale of gas."[26] Rather, such a condition would allow a *pipeline* to obtain reasonable take-or-pay relief (as defined by the Commission) from those producers that want the privilege of gaining access to the pipeline's system. As the court of appeals correctly observed, neither the NGA nor the NGPA mandate that producers be granted unfettered access to interstate transportation and enjoy the new market opportunities thereby created. App. at 93a-94a.

An access condition is fully consistent with the Congressional intent of the NGPA. While Congress envisioned that wellhead prices would be determined by market forces, it was legislating against a background in which the buyers in that market consisted largely of interstate pipelines. Order No. 436 fundamentally changes market conditions and benefits producers by adding new buyers to the market. The decision below recognizes that the NGA and NGPA do not require the Commission to create new market opportunities for producers. An ac-

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[25] Section 601(c)(1) provides under the heading "Guaranteed passthrough" that: "The Commission may not deny, or condition the grant of, any certificate under Section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable. . . ."

[26] Subsequent to the NGPA and prior to Order No. 436, the Commission routinely attached conditions to certificates which limited the gas eligible for transportation (including limitations based on price) without serious challenge to their validity. *See, e.g.*, Tenneco Oil Co., 29 F.E.R.C. (CCH) ¶ 61,334 at 61,700 (1984); Tenneco Oil Co., 26 F.E.R.C. (CCH) ¶ 61,030 at 61,072 (1984).

cess condition, such as take-or-pay crediting, allows pipelines to make the transition to these new market circumstances.

2. *The NGPA Does Not Bar The Commission's Exercise Of its Authority To Modify Non-Price Terms In Jurisdictional Contracts*

In the NGPA, Congress removed certificate jurisdiction over producer-pipeline sales of "new" and price-deregulated gas.[27] But it retained certificate jurisdiction—and, hence, NGA § 5 authority[28]—over producer-pipeline sales of so-called "old" gas. The court of appeals described this as "perfectly standard grandfathering." App. at 90a.

Producers nonetheless contend that the Commission is prohibited from exercising its NGA § 5 authority to mitigate high take-or-pay provisions in *jurisdictional* producer-pipeline contracts because such provisions interact with contractual price provisions to prevent the efficient functioning of the gas market.[29] But such authority, if

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[27] Section 601(a)(1), of the NGPA, 15 U.S.C. § 3431(a)(1), sets forth the categories of gas sales that are no longer subject to NGA sales jurisdiction.

[28] Section 5 of the NGA, 15 U.S.C. § 717d, provides in pertinent part that whenever the Commission finds that "any rule, regulation, practice or contract" subject to its transportation or sales jurisdiction "is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable . . . rule, regulation, practice or contract to be thereafter observed and in force, and shall fix the same by order . . . ."

[29] Pennzoil Co. v. FERC, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982), cited at page 12 n.33 of Producers petition, is inapposite. That case dealt only with the question of the Commission's authority to interpret the rate-setting provisions of *non-jurisdictional contracts*—those contracts that Congress removed from the Commission's NGA sales certificate jurisdiction. Nor does Office of Consumer Counsel v. FERC, 783 F.2d 206 (D.C. Cir. 1986) (cited at page 10 n.25 of Producers' petition) support Producers' claim. To the contrary, the court of appeals upheld a

exercised,[30] would not prescribe price levels or require producers to charge any particular price. Above-market contract prices are problematic only where the contract requires the pipeline to take or pay for the gas without regard to market price. The Commission found in Order No. 436 that such take-or-pay provisions prevent the development of an efficient, competitive market for natural gas at the wellhead.[31]

By reducing to just and reasonable levels the maximum obligations of pipelines to take gas under jurisdictional contracts entered into during the gas shortage, the Commission would be creating *market conditions* which allow *market forces* to determine whether the contract price is too high. Thus, a Commission decision to exercise its NGA § 5 authority to modify non-price provisions in pre-NGPA contracts over which it has jurisdiction because they impede the transition to a competitive market would be fully consistent with the specific language of section 5 and with Congressional intent. *Cf. Conway Corp. v. FPC*, 510 F.2d 1264, 1270-72 (D.C. Cir. 1975), *affirmed*, 426 U.S. 271, 279 (1976).

B. In Remanding the Case to the Commission the Court of Appeals Correctly Applied the Arbitrary-and-Capricious Test

Invoking this Court's *Chevron* decision,[32] Producers accuse the court of appeals of failing to defer to the Com-

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Commission finding that certain take-or-pay clauses in producer-pipeline contracts had become unjust and unreasonable under section 5 of the NGA.

[30] Again, Producers challenge is hypothetical. The court of appeals did not direct the Commission to exercise its NGA § 5 power and the Commission has not done so.

[31] The court of appeals observed that "the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure." App. at 91.

[32] Chevron, U.S.A. v. Natural Resources Defense Council, *supra*, 467 U.S. 837.

mission's decision. However, *Chevron* should not become "a talisman under which any agency decision is by definition unimpeachable." *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29, 50 (1983) ("*State Farm*"). Producers do not raise any issues of administrative law that require the Court to exercise supervisory authority over the court below. The Commission has neither complained that its authority has been usurped nor sought Court review of the remand order. Review is sought by those who would take advantage of the market opportunities of Order No. 436 to sell less expensive "spot market" gas into traditional pipeline sales markets and require pipelines to take or pay for more expensive long-term gas supply acquired to meet their sales obligations under certificates issued by the Commission.

In remanding the case to the Commission, the court of appeals properly applied this Court's teaching in *State Farm* to set aside arbitrary and capricious agency action. *Id.* at 42-43. The court of appeals correctly identified the three premises upon which the Commission's refusal to act was based: (1) Order No. 436 would not cause take-or-pay liabilities to increase; (2) certain policy considerations militated against regulatory relief; and (3) the most prominent remedies (exercise of NGA § 5 power to modify unjust and unreasonable take-or-pay provisions; and limitations on open access where producers refuse to cooperate in mitigating the impact of Order No. 436 on pipeline take-or-pay) were flawed. App. at 80a. It remanded Order No. 436 because the first and third premises were wholly insupportable. App. at 81a-86a, 89a-94a.

The court of appeals explained in great detail why it could not accept the Commission's assertion that Order No. 436 would not increase pipeline take-or-pay exposure and make the resolution of these liabilities more difficult and expensive. App. at 80a-86a. It concluded that

"FERC's seeming blindness to the possible impact of Order No. 436 on take-or-pay liability . . . seem[s] impossible to square with the requirement of reasoned decisionmaking." App. at 84a. The Court's analysis is amply supported by the Commission's subsequent admission that it had no reliable information on the extent of the take-or-pay problem and its action in Order No. 500 to obtain this critical data.[33] Producers do not attempt to rebut the court's careful analysis, but instead offer various excuses for the Commission's "utterly Panglossian" factual assessment. But reasoned decisionmaking requires more than a "minimum rationality." *State Farm, supra,* 463 U.S. at 42 n.9. The court of appeals was not required to accept uncritically an explanation that "runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise." *Id.* at 43.[34]

The court of appeals also identified fatal weaknesses in the reasons offered by the Commission for rejecting the significant alternatives to its no-action course. App. at 89a-94a. It found the Commission's explanation of the reasons for its rejection of Section 5 action to be so unclear and lacking in content that the legality of the Commission's analysis could not be reviewed. App. at 90a. While remanding for further consideration, the majority opinion even suggested possible justifications to the Commission in support of its refusal to exercise its section 5 power. *Id.* This is hardly indicative of a court whose purpose and intent is to substitute its judgment for the agency's.

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[33] *See* n.20 & 21, *supra,* and accompanying text.

[34] Nor can the Commission's actions be defended by arguing that the dimensions of the take-or-pay problem were uncertain. It was incumbent upon the Commission to explain the reason why it was necessary to act without "engaging in a search for further evidence." State Farm, *supra,* 463 U.S. at 52.

The court of appeals similarly found implausible the Commission's primary reason for refusing to consider some form of take-or-pay relief in return for giving producers the privilege of access to pipeline systems—the claim that such a refusal would always be unduly discriminatory. The court stated:

> Given that the Commission itself has identified the producer-pipeline contracts as a primary cause of the problem that Order No. 436 is intended to cure, it eludes us why pipeline denial of access to producers that stand on the letter of their contract rights should be viewed as unduly discriminatory. It is clear that § 5 does not prohibit every distinction. FERC offers no reason why it views this one as beyond the pale.

App. at 91a-92a (citations omitted).

Producers again do not address the court of appeals analysis; they merely repeat the Commission's claim that any policy other than unrestricted access to interstate transportation is unduly discriminatory, and cite the other policy considerations raised by the Commission. (Pet. Br. at 18-19) But the court of appeals was not required to speculate whether the Commission's other policy considerations would tip the scales in favor of non-intervention in the absence of an unjustified concern that restricting access would be unduly discriminatory on its face. It properly remanded in order to allow the Commission to determine "to what extent these policy considerations may justify its inaction on the uneconomical producer-pipeline contracts." App. at 94a.

III. THE COURT SHOULD NOT RENDER AN ADVISORY OPINION ON THE SCOPE OF THE STATES' JURISDICTION OVER THE INTERSTATE TRANSPORTATION OF NATURAL GAS

SoCal's petition in No. 87-1091 challenges the Commission's authority to adopt Optional Expedite (OEC) procedures to process applications for certificates. In decid-

ing whether to issue an OEC, the Commission stated it would not consider factors that have traditionally been used to justify denial of certificates—particularly duplication of facilities and the impact on the LDC of transactions in which interstate pipelines propose to transport gas directly to end-users without utilizing the facilities of the local distribution company (the so-called "bypass issue"). *See* App. at 102a.

In Part III of its petition, SoCal argues that the Court must review the *AGD* decision in order to declare that the states have the authority to regulate the interstate transportation of gas by an interstate pipeline at some point prior to the point at which the gas is received by the customer. SoCal claims this jurisdictional issue is ripe for review because the Commission and the court of appeals relied on the existence of the authority of the states to regulate such interstate transportation of gas, and establish their own certification standards, to determine that the Commission could change its certification policies. (SoCal Br. at 11) Tennessee opposes SoCal's request for clarification.

SoCal's argument concerning the need to "clarify" the scope of state jurisdiction rests on a fundamental misreading of Order No. 436 and the *AGD* decision. *AGD* did not uphold the OEC regulations on the ground that the states have comparable authority to impose their own certification requirements and veto or re-arrange a transportation proposal that would bypass an LDC. The Commission and the court of appeals concluded that where the applicant for a certificate must assume the full economic risk of the venture, the risk of wasteful bypass is remote.[35] While the Commission in Order No. 436 and

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[35] App. at 104a. The court explained in detail that the risk of bypass largely is a function of *rate* policies established by state regulatory agencies that allow LDCs to extract from disfavored customers "a disproportionate share of [the LDC's] costs." App. at 106a.

the court in *AGD* referred to the authority of the states to control direct sales,[36] neither Order No. 436 nor the *AGD* decision purport to establish the bounds of state jurisdiction. The court of appeals stated that: "The exact scope of this power is unplumbed and is not before us now." App. at 106a.

The Court does not have before it an actual case or controversy in which the FERC has issued a certificate to an applicant for the interstate transportation of gas into a state over the objection of a state agency which maintains that it has jurisdiction to regulate the transaction. SoCal asks this Court to venture an advisory opinion without a specific factual anchor and the detailed maps provided by agency and appellate decisions concerning the respective Constitutional and statutory allocation of regulatory authority between the FERC and state regulatory agencies. This is "too remote and abstract an inquiry for the proper exercise of the judicial function." *International Longshoreman's and Warehouseman's Union, Local 37 v. Boyd*, 347 U.S. 222, 224 (1954).

The issue before the Court is not whether the Commission's decision to de-emphasize certain factors in certificate proceedings is justified because the states can assume the regulatory mantle; the issue is whether the Commission can properly de-emphasize these factors

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[36] App. at 106a. *See* Panhandle Eastern Pipe Line Co. v. Michigan Public Service Comm., 341 U.S. 329 (1951). Under the NGA, the Commission's sales jurisdiction extends only to sales for resale. *Panhandle* involved an exercise by the states of their authority to regulate direct sales, that is, sales for ultimate consumption. By contrast, the Commission's jurisdiction over interstate transportation is plenary. The Commission has ruled that the transportation and delivery of gas by an interstate pipeline to a customer is not "local distribution" of natural gas subject to state jurisdiction Mojave Pipeline Co., 35 F.E.R.C. (CCH) ¶ 61,199 (1986), *rehearing denied*, 41 F.E.R.C. (CCH) ¶ 61,040 (1987), *appeal pending*, Public Utilities Comm. on California v. FERC, No. 87-1679 (D.C. Cir.).

where the applicant has agreed to accept conditions which subject new services to the discipline of the marketplace. The resolution of the issue properly before the Court does not depend on the existence *vel non* of state regulatory authority.

CONCLUSION

The petitions for a writ of certiorari in Nos. 87-978 and 87-~~1091~~ should be denied.

Respectfully submitted,

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March 16, 1988

SUPPLEMENTAL APPENDIX
TO
BRIEF IN OPPOSITION

Letter to Honorable Frank Horton, from Acting FERC Chairman Anthony G. Sousa, April 23, 1986

SUPPLEMENTAL APPENDIX

FEDERAL ENERGY REGULATORY COMMISSION
Washington, D.C. 20426

April 23, 1986

Honorable Frank Horton
House of Representatives
Washington, D.C. 20515

Dear Mr. Horton:

Thank you for your letter of March 18, 1986, in which you expressed your concern about the effect of take-or-pay provisions in natural gas contracts and the Commission's issuance of Order No. 436. Your letter posed eight questions to me regarding take-or-pay. My response to your inquiry is as follows.

(1) Are we correct that the FERC, and its predecessor the FPC, required a showing of a long term supply of gas as well as a long term market for the gas prior to authorizing transmission companies to construct and operate their proposed facility?

Under section 7(c) of the Natural Gas Act (NGA), pipeline companies seeking to initiate service or seeking to serve major new markets must show that their source(s) of supply are adequate to meet the needs of the new or expanded market. One measure of gas supply is "deliverability life," expressed in terms of the number of years a pipeline can meet its current annual requirements using the relevant source(s) of supply, given the certificated delivery capacity of the pipeline. Until the late 1960's, pipelines seeking Commission authorization to commence new or expanded service were required to show that their source(s) of supply had a minimum twelve-year deliverability life. The Commission adopted a more flexible policy in 1967, (18 C.F.R. § 2.61) which

had the effect of eliminating the requirement of a specific deliverability showing where (a) a pipeline had active gas procurement operations and (b) a pipeline's system extended into active production areas. The Commission's current policy is to review all applications for new or expanded service filed under section 7(c) of the NGA on a case-by-case basis to determine if an adequate supply of gas is available to support the application.

(2) Are we correct in assuming that your regulations require that the pipelines sell the gas to their distributor company customers at the same price that they buy it from the producers plus the cost of transportation from the production area to the market area?

Generally, a pipeline is not permitted to sell gas for more than the purchase price. Furthermore, under section 601 of the Natural Gas Policy Act of 1978 (NGPA), pipelines are guaranteed the right to passthrough their purchased gas costs to their customers to the extent the amount paid is just and reasonable and not excessive due to fraud, abuse, and similar grounds. Also included in a pipeline's cost of service are costs attributable to production, storage and transmission.

(3) Do most of the contracts between pipeline companies and the producers contain take-or-pay clauses?

Contracts for the sale of natural gas have traditionally contained provisions requiring the purchaser to take-or-pay for specified quantities of gas and the vast majority of current gas contracts contain take-or-pay provisions. Most contracts also contain a 5-year make up period in which producers are obligated to maintain the ability to deliver the gas paid for but not taken.

(4) What is the *current* magnitude of these liabilities?

The data submitted under our current regulations do not provide sufficient information to assess the current magnitude of these liabilities.

It is important to distinguish between actual prepayments made for gas not taken and a pipeline's potential take-or-pay liability under its contracts. Payments made before the expiration of the make up period are prepayments. Prepayments are treated as an asset of the pipeline and are added to the pipeline's rate base, along with any interest incurred by the pipeline to finance its prepayments. In some cases, a pipeline may not be able to market its prepaid gas during the make up period and, since prepayments are not purchased gas costs, the pipeline cannot automatically passthrough its prepayments.

A pipeline's take-or-pay liability is not suspectible to accurate estimate, because it is difficult to estimate the extent to which a pipeline will be unable to take gas during the make up period for which it has already paid or will be required to pay, and therefore for which it may become legally "liable." In addition, estimates are based on current levels of purchases and projected market demand, each of which may change during the make up period. Some pipelines include a discussion of their take-or-pay problems in their annual reports and Form 10-K quarterly reports filed with the Securities and Exchange Commission (SEC). As of November 1985, actual take-or-pay prepayments included in the rate base of major pipelines totalled approximately $650 million as computed by the FERC.

(5) It is our understanding that there is a significant delay between the time a pipeline incurs this liability and when they make payments. If this is correct, explain this delay. How does your response to question four above recognize this delay, if in fact it occurs?

Typical take-or-pay clauses define the "take" requirement in terms of a specific volume of gas which must be taken by the pipeline within a specific period of time, usually the contract year. The Commission does not impose specific reporting requirements on pipelines to moni-

tor take-or-pay payments and may learn of a pipeline's prepayments for the first time when a pipeline attempts to recover its costs and files its next rate case. Nothing in the Commission's regulations prevents a pipeline from making take-or-pay payments as soon as it contractually incurs them. To some extent, the estimates provided in response to question number four reflect this delay. To a greater extent, however, the imprecise quantification of take-or-pay liability can be traced to the historic and present reluctance of both pipelines and producers to make this information available, especially with respect to gas purchase contracts for gas not subject to the Commission's jurisdiction.

(6) In your notice of RM85-1 did you solicit information on current magnitudes of pipeline take-or-pay exposures? Was it provided with any degree of specificity? Does the Commission have any data on the extent to which Order Nos. 380 and 436 will increase pipelines' take-or-pay exposure? If so, what does this data reflect?

Over the last four years, the Commission has initiated several rulemaking proceedings in which take-or-pay has been an issue. In two recent proceedings (Docket Nos. RM85-1-000 and RM86-3-000), various members of the different segments of the industry have presented conflicting views on the magnitude of the take-or-pay problem.

At the moment, there are no data on the extent to which Order No. 436 may increase pipelines' take-or-pay exposure. We do know that take-or-pay prepayments have remained stable or declined slightly between 1982 and 1985.

(7) It is our understanding that the pipelines have not overwhelmingly availed themselves of Order No. 436 provisions. Please furnish the names of those companies who have availed themselves of the provisions. Has the implementation of the open access provision by these com-

panies been acceptable to their customers and their traditional suppliers? What impact has pipelines' increased take-or-pay exposure had on their decision to operate under Order No. 436?

The following companies have made blanket certificate or rate settlement filings under Order No. 436: Gas Gathering Corporation, Valley Gas Transmission, Inc., Mid Louisiana Gas Company, Columbia Gulf Transmission Company, Columbia Gas Transmission Corporation, Ozark Gas Transmission System, Gas Transport, Inc., Valero Interstate Transmission Company, Consolidated Gas Transmission Corporation, Erie Pipeline System, Seagull Interstate Corporation, Texas Eastern Transmission Corporation, Superior Offshore Pipeline Company, Northern Border Pipeline Company, Transcontinental Gas Pipeline Company, Transco Offshore Gathering Company, Transwestern Pipeline Company, and El Paso Natural Gas Company. In addition, many of these companies and others have provided self-implementing transportation services on an interim basis under Order No. 436 and section 311 of the Natural Gas Policy Act of 1978.

Since companies have only recently begun to transport gas pursuant to Order No. 436, it is too early to determine whether their participation has been acceptable to their customers and their suppliers. It is also difficult to determine whether and to what extent take-or-pay exposure has influenced pipelines' decisions on participation in Order No. 436.

(8) Are you aware of any pipeline companies whose financial abilities may be impaired by take-or-pay liabilities?

It is difficult to determine whether any pipelines have been financially impaired because of their take-or-pay liability. This may be discussed in filings made by pipe-

line companies with the Securities and Exchange Commission and in annual reports.

I hope this information is helpful to you. If I can be of further assistance to you in this or any other Commission matter, please let me know.

Sincerely,

/s/ Anthony G. Sousa
ANTHONY G. SOUSA
Acting Chairman

(5) (4) (3) (4) (5)

Nos. 87-976, 87-977, 87-978, 87-979, and 87-1091

In the Supreme Court of the United States

OCTOBER TERM, 1987

Supreme Court, U.S.
FILED
MAR 16 1988
JOSEPH F. SPANIOL, JR.
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INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

TEXAS EASTERN TRANSMISSION CORPORATION, PETITIONER

v.

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ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether, upon determining that interstate natural gas pipelines were engaging in an unduly discriminatory and anticompetitive practice by refusing to provide transportation services to companies that choose to purchase natural gas from producers and other sellers rather than from the pipelines themselves, the Federal Energy Regulatory Commission correctly concluded that it had the statutory authority to eliminate such unlawful discrimination by requiring pipelines that transport gas under certain expedited regulatory procedures to offer transportation service on an "open access" basis.

2. Whether the court of appeals properly remanded to the Commission, for further consideration and explanation, the Commission's decision to take no action at this time with respect to the "take-or-pay" provisions in contracts between natural gas producers and interstate pipelines.

3. Whether the Commission acted within its statutory authority in establishing an optional expedited certificate procedure to ease regulatory barriers that would otherwise obstruct the provision of new pipeline services.

TABLE OF CONTENTS

	Page
Opinions below	2
Jurisdiction	2
Statement:	
A. Statutory and regulatory background	2
B. Order No. 436	6
C. The decision of the court of appeals	12
Argument	16
Conclusion	31

TABLE OF AUTHORITIES

Cases:

Abbott Laboratories v. *Gardner*, 387 U.S. 136 (1967)	29
American Paper Institute v. *American Electric Power Service Corp.*, 461 U.S. 402 (1983)	
American Tobacco Co. v. *Patterson*, 456 U.S. 63 (1982)	20
Atlantic Refining Co. v. *Public Service Comm'n*, 360 U.S. 378 (1959)	18
Central West Utility Co. v. *FPC*, 247 F.2d 306 (3d Cir. 1957)	26
Chevron U.S.A. Inc. v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984)	21
FCC v. *Midwest Video Corp.*, 440 U.S. 689 (1979)	24
FPC v. *Conway Corp.*, 426 U.S. 271 (1976)	3
FPC v. *Texaco Inc.*, 377 U.S. 33 (1964)	28
Florida Power & Light Co. v. *FERC*, 660 F.2d 668 (5th Cir. 1981), cert. denied, 459 U.S. 1156 (1983)	25

Cases—Continued: Page

Maryland People's Counsel v. *FERC*:
761 F.2d 768 (D.C. Cir. 1985) 6, 7
761 F.2d 780 (D.C. Cir. 1985) 6, 7
National Tour Brokers Ass'n v. *ICC*, 671 F.2d 528 (D.C. Cir. 1982) 28
New York State Electric & Gas Corp. v. *FERC*, 638 F.2d 388 (2d Cir. 1980), cert. denied, 454 U.S. 821 (1981) 26
Otter Tail Power Co. v. *United States*, 410 U.S. 366 (1973) 24, 25
Panhandle Eastern Pipe Line Co. v. *Michigan Public Service Comm'n*, 341 U.S. 329 (1951) 16, 30
Princeton Univ. v. *Schmid*, 455 U.S. 100 (1982) .. 30
Public Service Comm'n v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) 3
Toilet Goods Ass'n v. *Gardner*, 387 U.S. 158 (1967) 29
Transcontinental Gas Pipe Line Corp. v. *State Oil & Gas Bd.*, 474 U.S. 409 (1986) 3
United States v. *Locke*, 471 U.S. 84 (1985) 18
United States v. *Storer Broadcasting Co.*, 351 U.S. 192 (1956) 28

Statutes and regulations:

Communications Act § 3(h), 47 U.S.C. 153(h) 24
Federal Power Act, 16 U.S.C. (& Supp. IV) 791a *et seq.* 24, 25
16 U.S.C. (& Supp. IV) 824j 26
16 U.S.C. 824k 26
Natural Gas Act, 15 U.S.C. 717 *et seq.* 2
§ 4, 15 U.S.C. 717c 3, 9, 16, 19
§ 4(a), 15 U.S.C. 717c(a) 3, 19
§ 4(b), 15 U.S.C. 717c(b) 3, 17
§ 5, 15 U.S.C. 717d 3, 9, 16, 19
§ 5(a), 15 U.S.C. 717d(a) 3, 17
§ 7, 15 U.S.C. 717f 2, 11, 12, 17, 19, 25, 27
§ 7(a), 15 U.S.C. 717f(a) 19, 20, 26
§ 7(b), 15 U.S.C. 717f(b) 3
§ 7(c), 15 U.S.C. 717f(c) 5, 9, 10, 18

Statutes and regulations—Continued: Page

§ 7(e), 15 U.S.C. 717f(e) 18
§ 16, 15 U.S.C. 717o 17

Natural Gas Policy Act, 15 U.S.C. 3301 *et seq.* 3

§§ 2-123, 15 U.S.C. 3301-3333 4
§ 121, 15 U.S.C. 3331 4
§ 311, 15 U.S.C. 3371 ..... 4, 5, 9, 10, 22, 23
§ 311(a), 15 U.S.C. 3371(a) 4, 22
§ 311(a)(1)(b), 15 U.S.C. 3371(a)(1)(b) 4
§ 311(b)(1), 15 U.S.C. 3371(b)(1) 21
§ 311(c), 15 U.S.C. 3371(c) 4, 22
§ 601, 15 U.S.C. 3431 4
§ 601(a)(2), 15 U.S.C. 3431(a)(2) 4
§ 602, 15 U.S.C. 3432 23
§ 602(b), 15 U.S.C. 3432(b) 21, 22, 23
§ 602(b)(1), 15 U.S.C. 3432(b)(1) 22
§ 602(b)(2), 15 U.S.C. 3432(b)(2) 21, 22

18 C.F.R.:

Section 157.102(b)(1)(iv) 28
Section 157.104 12
Section 284.8(b) 9, 18
Section 284.9(b) 18

Miscellaneous:

44 Fed. Reg. (1979):

p. 52179 ..... 5, 23
pp. 52180-52181 23

48 Fed. Reg. 34872 (1983) 5
50 Fed. Reg. (1985):

p. 114 6
p. 3801 6
p. 3806 .....
p. 24130 7
p. 42408 7
p. 42412 7
p. 42413 ..... 7, 8
p. 42421 ..... 8, 9
p. 42424 9

Miscellaneous—Continued: Page

pp. 42424-42425 9
pp. 42426-42428 10
p. 42427 21
p. 42428 10
p. 42429 23
p. 42430 9
pp. 42438-42447 10
pp. 42447-42455 10
pp. 42462-42465 11
p. 42467 11
pp. 42467-42476 11

52 Fed. Reg. (1987):

p. 30334 14
p. 30351 14
p. 39630 14
p. 48986 14

H.R. Rep. 95-543, 95th Cong., 2d Sess. (1977) 4
Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 346 (1983) 5

In the Supreme Court of the United States

OCTOBER TERM, 1987

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BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-128a) is reported at 824 F.2d 981.[1] The orders of the Federal Energy Regulatory Commission are reported at 50 Fed. Reg. 42408 (1985); as corrected, 50 Fed. Reg. 45907 (1985); on reh'g, 50 Fed. Reg. 52217 (1985), 51 Fed. Reg. 6398, 11566, and 11569 (1986).

JURISDICTION

The judgment of the court of appeals was entered on June 23, 1987, and petitions for rehearing were denied on September 15, 1987. The petitions for a writ of certiorari in Nos. 87-976, 87-977, 87-978, and 87-979 were filed on December 14, 1987. The petition for a writ of certiorari in No. 87-1091 was filed on December 11, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

A. Statutory and Regulatory Background

1. The Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.*, gave the Federal Energy Regulatory Commission comprehensive regulatory authority over companies that engage in either the sale of natural gas for resale or the interstate transportation of natural gas. That authority extends to both gas producers, which produce and sell natural gas, and natural gas pipelines, which transport and sell natural gas.

The Commission regulates market entry through its authority under Section 7 of the NGA, 15 U.S.C. 717f, to issue certificates of public convenience and necessity, subject to such conditions as the Commis-

[1] "Pet. App." refers to the joint appendix to the petition for a writ of certiorari in No. 87-976.

sion deems appropriate, authorizing natural gas companies to transport or sell gas. The Commission regulates market exit through its authority to grant permission to abandon certificated service (see 15 U.S.C. 717f(b)). In addition, under Sections 4 and 5 of the NGA, 15 U.S.C. 717c and 717d, the Commission regulates the price and other terms of jurisdictional sales and transportation, ensuring that the rates and charges for such service, as well as all rules, regulations, practices, and contracts affecting those rates and charges, are just and reasonable (see 15 U.S.C. 717c(a)).

Section 4(b) of the NGA prohibits natural gas companies from granting "any undue preference or advantage" or maintaining "any unreasonable difference in rates, charges, service, * * * or in any other respect * * *" (15 U.S.C. 717c(b)). Section 5(a) directs the Commission to exercise its remedial authority to eliminate rates or practices that are "unjust, unreasonable, unduly discriminatory, or preferential" (15 U.S.C. 717d(a)). Finally, the Act requires the Commission to evaluate and remedy any anticompetitive behavior by natural gas companies. *E.g.*, *FPC* v. *Conway Corp.*, 426 U.S. 271, 278-279 (1976).

2. Congress altered the operation of the NGA in 1978 when it adopted the Natural Gas Policy Act (NGPA), 15 U.S.C. 3301 *et seq.* That statute was designed "to give market forces a more significant role in determining the supply, the demand, and the price of natural gas." *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd.*, 474 U.S. 409, 422 (1986); see also *Public Service Comm'n* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983) (the NGPA "comprehensively and dramatically" changed the scheme of regulation under the Natural Gas Act).

The NGPA eliminated price regulation of sales of "new" gas, substituting a single scheme of statutory ceiling prices for wellhead sales ("first sales") of natural gas (15 U.S.C. 3301-3333) and a timetable for the gradual decontrol of all wellhead sales (15 U.S.C. 3331). The statute also removed deregulated gas from certificate and abandonment requirements imposed by the Natural Gas Act.[2]

The NGPA also modified regulation of pipelines under the NGA. Section 311(a) of the NGPA, 15 U.S.C. 3371(a), creates an alternative regulatory framework for gas transportation that is designed to promote the development of a unified pipeline transportation network. See H.R. Rep. 95-543, 95th Cong., 2d Sess. 47 (1977). The provision states that the Commission "may" allow interstate pipelines and intrastate pipelines to transport gas for each other, as well as for local distribution companies; any transportation permitted by the Commission under Section 311 is exempted from the certificate and abandonment requirements of the Natural Gas Act (15 U.S.C. 3431 (a)(2)). Section 311 transportation remains subject to the Commission's ratemaking authority (15 U.S.C. 3371(a)(1)(B)) as well as to "such terms and conditions as the Commission may prescribe" (15 U.S.C. 3371(c)).

This revamped statutory scheme has led to a restructuring of the natural gas industry. Prior to the adoption of the NGPA, interstate natural gas pipelines functioned primarily as merchants, buying gas from producers at the "wellhead" and then transporting that gas for resale to the pipelines' customers—

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[2] Section 601 of the NGPA, 15 U.S.C. 3431, coordinates the provisions of the NGPA with the Commission's regulatory authority under the NGA.

local distribution companies that buy gas at wholesale for subsequent resale and large "end users" that buy gas at retail for their own consumption. See Pet. App. 17a; Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 346, 348 (1983). Since the adoption of the NGPA, however, pipelines have increasingly provided "unbundled" transportation services: local distribution companies and end users buy gas directly at the wellhead from producers and other sellers; the pipelines' role is to transport this "third-party" gas from seller to buyer.

Pipelines generally have provided these transportation services under one of several streamlined authorization procedures that replaced the traditional—and more time-consuming—Section 7(c) certificate proceeding and were designed by the Commission to give pipelines increased flexibility in the provision of transportation services. Under Section 311, the Commission has authorized interstate and intrastate pipelines to provide certain categories of transportation service on a "self-implementing basis"; a pipeline receives a blanket authorization for the provision of transportation services that eliminates the need for advance Commission approval of individual transactions. See 44 Fed. Reg. 52179 (1979). The Commission has established similar streamlined procedures for other categories of transportation services pursuant to its authority under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c). See, *e.g.*, 48 Fed. Reg. 34872 (1983).

B. Order No. 436

1. In early 1985, the Commission published two notices of inquiry stating its intent to explore solutions to certain problems in the provision of trans-

portation services. 50 Fed. Reg. 114 (1985); 50 Fed. Reg. 3801 (1985). One concern identified by the Commission was the pipelines' refusal in certain circumstances to transport third-party gas. Pipelines generally provided this service only to customers capable of switching to alternative fuels. As a result, so-called "captive customers" were generally unable to buy gas at the wellhead because the pipelines would not provide the transportation service needed to move the gas from the seller to the buyer.

Due to a growing surplus in the gas supply in recent years, the price of gas at the wellhead has fallen; the price of gas sold by pipelines, by contrast, has remained relatively high. In response to customers' efforts to obtain transportation services for third-party gas purchased at the wellhead, pipelines have segmented their market: pipelines generally have provided third-party gas transportation services only to those "fuel-switchable" customers that would otherwise leave the pipeline entirely; the pipelines offered sales service—but not transportation service—to the captive customers forced to purchase gas from the pipeline because they could not switch to another fuel source. Pet. App. 20a-23a.

Several months after the Commission issued the notices of inquiry, the United States Court of Appeals for the District of Columbia Circuit vacated and remanded orders establishing two of the Commission's alternative transportation programs. The court held that the Commission had failed to respond adequately to contentions that those programs were unduly discriminatory because transportation services were available only to fuel-switchable customers and not to captive customers. *Maryland People's Counsel* v. *FERC*, 761 F.2d 768 (D.C. Cir. 1985); *Maryland People's Counsel* v. *FERC*, 761 F.2d 780 (D.C. Cir.

1985). Shortly thereafter, the Commission issued a notice of proposed rulemaking proposing to adopt a new rule governing pipelines' authority to provide transportation services (50 Fed. Reg. 24130 (1985)).[3]

2. In October 1985, the Commission adopted Order No. 436, which comprehensively altered regulation of pipeline transportation to take account of the competitive forces unleashed by the NGPA (50 Fed. Reg. 42408). The Commission found that as a result of changes in the natural gas industry accelerated by the removal of price controls mandated by the NGPA, "natural gas has become a separate and distinct economic *commodity* * * * distinct from transportation and distinct from [other pipeline services]" (*id.* at 42412 (emphasis in original)). It stated that the elimination of price regulation of first sales of most natural gas resulted in a "generally competitive market" in that commodity (*id.* at 42413).

The Commission further found that significant changes had taken place with respect to interstate pipeline transportation of natural gas: in some markets two or more pipelines competed against one another; in other markets, however, there remained only a single pipeline supplier. In addition, "the maturing of the pipeline industry in recent decades has meant that there is now an interconnected nationwide pipeline grid" (50 Fed. Reg. 42412 (1985)). The result of these changes was "[a] highly integrated *transportation* network, highly monopolistic in some markets,

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[3] The D.C. Circuit stayed its mandates in the two *Maryland People's Counsel* cases to allow transportation service to continue until the Commission completed the rulemaking proceeding that culminated in the rule at issue in the present case. *Maryland People's Counsel* v. *FERC*, 768 F.2d 450 (D.C. Cir. 1985); *Maryland People's Counsel* v. *FERC*, 768 F.2d 1354 (D.C. Cir. 1985).

fairly competitive in others; over which Congress has generally determined to retain utility-type regulation over market entry, exit and price; but for which Congress has also allowed an alternative approach [under NGPA § 311] in which there may be no restrictions as to market entry and exit, but for which Congress expressly retained regulation as to rates" (*id.* at 42413 (emphasis in original)).

The Commission concluded that it was appropriate to continue regulatory supervision over transportation services, but to do so in a manner that allowed the commodity market for natural gas to develop in a competitive fashion. "In this way, regulation will allow competitive forces to operate in those areas where Congress has determined they will better protect the public interest than traditional utility-type regulation, while retaining the traditional-type regulation in those areas where competitive forces have been found inadequate by the Congress" (50 Fed. Reg. 42413 (1985)).

The Commission also found that natural gas purchasers "seeing the availability of supplies in the field at [lower] prices * * * are seeking to purchase gas directly in the field and have it transported to [them] * * * in competition with the system supplies which the pipeline retains under certain uneconomic long-term contracts" (50 Fed. Reg. 42421 (1985) (footnotes omitted)). However, "pipelines have generally expressed a reluctance to provide these transportation services on a non-discriminatory basis to their existing sales customers or to customers without immediate fuel-switching capability"; they provided such services only to customers capable of abandoning the pipeline in favor of an alternate fuel source (*ibid.* (footnote omitted)). The Commission determined that this discrimination in the provision of transpor-

tation services "impeded the ability of natural gas consumers to secure the rewards of competition in natural gas markets commensurate with the[ir] risks"; in particular, the Commission concluded that consumers had been deprived of the benefit of lower field prices for natural gas because they were unable to obtain transportation for that lower-priced gas. *Ibid.*; see also *id.* at 42424 ("permitting pipelines to unduly discriminate or to exclude certain consumers from transportation services is inconsistent with the fundamental goals of consumer protection and competition in the Natural Gas Act and the Natural Gas Policy Act").

In order to remedy this problem, the Commission consolidated its various alternative transportation procedures into two streamlined procedures: pipelines were authorized to transport gas without prior Commission approval either under Section 311 of the NGPA or under a "blanket certificate" issued under Section 7(c) of the NGA. However, the Commission imposed an "open-access" condition upon pipelines obtaining blanket certificates or providing Section 311 transportation: such pipelines must provide transportation service "without undue discrimination, or preference" (18 C.F.R. 284.8(b)). This condition was designed to prevent pipelines from refusing to transport third-party gas purchased from a seller competing with the pipeline. See 50 Fed. Reg. 42421, 42424-42425, 42430 (1985).

The Commission examined and rejected claims, advanced mainly by pipelines, that the open-access condition exceeded the Commission's authority because it transformed pipelines into common carriers. The Commission concluded that the open-access condition was merely an exercise of the Commission's authority, under Sections 4 and 5 of the NGA, to remedy

undue discrimination and anticompetitive behavior.[4] The Commission stressed that the open-access condition extended only to pipelines that made use of the blanket "self-implementing" authority to provide transportation services set forth in Section 311 of the NGA and the Commission's rules under Section 7(c); the condition does not automatically apply to traditional Section 7(c) certificates authorizing individual transactions. The Commission stated that in the latter situation it would consider on a case-by-case basis whether the open-access condition was necessary to remedy undue discrimination and anticompetitive behavior. The Commission further concluded that, because the open-access condition applied only to those pipelines that chose to utilize the self-implementing transportation authority, it was voluntary, and therefore did not amount to a common carriage obligation. 50 Fed. Reg. 42426-42428 (1985).[5]

The Commission rejected claims that the open-access condition should not be imposed because it would reduce sales of gas by pipelines and therefore increase pipelines' liability to producers under contractual take-or-pay provisions.[6] In the Commission's

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[4] The Commission also found that its broad power to impose conditions upon the provision of transportation services under Section 311 of the NGPA justified the open-access condition. See 50 Fed. Reg. 42428 (1985).

[5] The Commission also adopted ratemaking principles designed to encourage pipelines to offer transportation services on a nondiscriminatory basis (50 Fed. Reg. 42447-42455 (1985)) and required pipelines making use of the blanket transportation authority to allow their customers to adjust contractual obligations to purchase gas from the pipeline (*id.* at 42438-42447). The latter provision allows pipeline gas-purchase customers to obtain transportation service while purchasing gas from other sources.

[6] "Take-or-pay" costs can result when the pipeline's contract with its supplier provides that the pipeline will take a

opinion these contractual problems could be settled among the parties in individual cases and did not justify continuation of unduly discriminatory transportation practices that deprived consumers of access to competitively priced gas. 50 Fed. Reg. 42462-42465 (1985).

Finally, the Commission established an "optional expedited certificate" (OEC) procedure to expedite the issuance of certificates of public convenience and necessity for new pipeline facilities and services pursuant to Section 7 of the NGA (see 50 Fed. Reg. 42467-42476 (1985)). The Commission indicated that the certification process could constitute a barrier to entry into the market for the provision of transportation services. The new procedure is "designed to provide consumers with greater options in the array of gas services available by giving pipelines the ability to offer new service and construct facilities on a timely basis" (*id.* at 42467). The Commission found that, by removing an obstacle to competition, the new procedure would stimulate efficiency in the construction of pipeline facilities and competition in the provision of services to pipeline customers (*ibid.*).

Under the procedure established by the Commission, certificates issued on an expedited basis are sub-

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particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take-or-pay" payments to its supplier. If the pipeline does incur take-or-pay costs, these costs generally may be included in the pipeline's rate base; the take-or-pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take-or-pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it has the opportunity to recover prudently incurred take-or-pay costs.

ject to conditions designed to ensure that the economic risk of the project is borne solely by the pipeline and not by ratepayers (see Pet. App. 96a n.32 (summarizing conditions)). In return, the applicant gains the benefit of a rebuttable presumption that the project meets the "public convenience and necessity" standard of Section 7, which obviates the need for a hearing in most cases. Parties who contest the application must raise genuine issues of material fact in order to obtain a hearing. See 18 C.F.R. 157.104.

C. The Decision of the Court of Appeals

The court of appeals upheld most elements of Order No. 436, including the open-access condition and the expedited certificate procedures. As to certain specified issues—including the take-or-pay question—the court directed the Commission to reconsider its determinations. See Pet. App. 1a-128a.[7]

The court of appeals unanimously upheld the factual findings underlying the Commission's order. The court observed that the Commission had found "(a) that pipelines continue to possess substantial market power; (b) that they have exercised that power to deny their own sales customers, and others without fuel-switching capability, access to competitively priced gas; and (c) that this practice has denied consumers access to gas at the lowest reasonable rates" (Pet. App. 30a (citations omitted)). And it found these findings basically unchallenged by the parties seeking to overturn the Commission's order. Indeed, the court observed that the pipelines' claim that the order would prevent pipelines from passing

[7] The court also remanded issues raised by the Commission's decisions to allow customers to adjust their contractual levels of service and to grandfather certain pre-existing transportation arrangements (Pet. App. 123a-124a).

on their own gas purchase costs "tends to substantiate the Commission's views (1) that in the absence of Order No. 436 competition will be thwarted and (2) that the practices controlled by Order No. 436 are indeed anticompetitive and discriminatory" (*id.* at 31a).

The court unanimously rejected the contention that the Commission lacked the statutory authority to impose the open-access condition upon its blanket authorizations for the provision of transportation services. Turning first to the Commission's authority under the Natural Gas Act, the court found that the Commission's broad power to eliminate discriminatory practices authorized the imposition of the open access condition and that this power was not diminished by the fact that the condition bears some resemblance to obligations imposed upon common carriers (Pet App. 25a-34a). The court also found that the Natural Gas Policy Act empowers the Commission to "control discrimination where the effort imposes on pipelines a duty—even though it be a conditional one—equivalent to the common carrier's duty to provide nondiscriminatory service" (*id.* at 35a).

The court of appeals remanded the "take-or-pay" issue to the Commission for further consideration. Various parties argued in the court of appeals that the provisions of Order No. 436, including the open-access condition, would have the effect of decreasing pipelines' gas sales and thereby increasing pipelines' exposure to contractual liability to producers under take-or-pay provisions. These parties asserted that the Commission had failed to give reasoned consideration to a number of potential solutions to this problem.[8] The court of appeals agreed, and directed the

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[8] In concluding that the Commission had failed to give reasoned consideration to claims that the open-access condi-

Commission to reconsider the matter. Pet. App. 75a-95a. The court declined to "require that FERC reach any particular conclusion" with respect to this issue, stating that it "merely mandate[d] that [the Commission] reach its conclusion by reasoned decision-making" (*id.* at 94a).[9]

The optional expedited certificate procedure was challenged on a number of grounds in the court of appeals. The court declined to address claims relating to the procedures for the application of the OEC rules, holding that those issues were not ripe for review (Pet. App. 97a-102a).

The court did address the challenges to the Commission's determination that certificate proposals conforming with the rules would be treated as presumptively consistent with the public convenience and necessity; the court upheld this determination by a

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tion would impede the settlement of take-or-pay liability by pipelines and producers the court rejected (Pet. App. 81a) the Commission's reliance on the "voluntary" nature of the open-access condition, holding that the use of the blanket transportation authority might be mandatory for some pipelines.

[9] Judge Mikva dissented with respect to this point, stating (Pet. App. 126a) that the Commission should be required on remand to take some affirmative action to assuage the take-or-pay problem.

Following the court of appeals' remand, the Commission issued an interim rule addressing the issues remanded by the court of appeals, including the take-or-pay problem. See 52 Fed. Reg. 30334 (1987), on reh'g, 52 Fed. Reg. 39630 and 48986 (1987), petitions for review pending, No. 87-4749 (5th Cir. filed Oct. 19, 1987), No. 87-1588 (D.C. Cir. filed Oct. 19, 1987). (Motions to resolve the venue question are now pending before the Fifth Circuit.) At the time it issued the interim rule, the Commission also solicited public comments regarding the appropriate final rule with respect to these issues (see 52 Fed. Reg. 30351 (1987)).

divided vote. The court first rejected the claim that the Commission's presumption "disregards important factors that Congress intended the Commission to consider" in the certification process (Pet. App. 102a). One of the purposes of certification is to " 'prevent uneconomic extensions and waste' " that would burden utilities' ratepayers (*id.* at 103a (footnote and citations omitted)). The court of appeals found that this purpose was not implicated by the presumption, because the presumption may be invoked only where a pipeline's investors bear all of the financial risks of the project; ratepayers cannot be affected adversely by such a project (*id.* at 103a-104a).

The court next concluded that the presumption did not improperly preclude consideration of the possibility that a new service might adversely affect existing firms and their captive customers. The court found that, under the Commission's criteria, applicants were likely to seek to enter a market in which the incumbent firm could lose customers only if the incumbent was inefficient or engaging in price discrimination, because that is the only context in which the applicant could be assured of recouping its investment. "If incumbent-firm inefficiency or price discrimination is the explanation, then certification will result in losses for a firm that, so far as appears, deserves to lose." Pet. App. 104a.

The court noted that in the case of an application to provide services in competition with a local distribution company such "deserved losses" may "ultimately fall not on [the distribution company's] shareholders but on its remaining customers—most notably its captive residential consumers," but it rejected arguments that the Commission's presumption violated congressional intent to the extent that it creates a risk that the local distribution company will be "bypassed" by a competitor (Pet. App. 105a).

First, the court accepted the Commission's view that the risk of bypass is "slight" because the distribution company will be free to compete in the market for the provision of transportation services, thus retaining the ability to earn a return on its fixed costs (*id.* at 105a-106a). Second, state authorities have power to regulate essentially local aspects of a bypass under this Court's decision in *Panhandle Eastern Pipe Line Co.* v. *Michigan Public Service Comm'n*, 341 U.S. 329 (1951). The court of appeals stated that that authority, and other options available to the states, would allow states to protect captive customers (Pet. App. 106a-107a). Finally, the court of appeals found that the Commission had adequately reconciled its decision in the present case with earlier decisions attempting to discourage bypass (*id.* at 111a-112a).[10]

ARGUMENT

Based on a comprehensive and detailed analysis of all aspects of Order No. 436, the court below upheld the substance of the order, remanding the matter to the Commission for further consideration of a limited number of specified issues. That thorough decision, upon which we rely, is correct and does not conflict with any decision of this Court or any other court of appeals. Review by this Court is not warranted.

1. The court of appeals held that the open-access condition of Order No. 436 was a proper exercise of the Commission's authority under Sections 4 and 5

[10] Judge Mikva dissented, concluding that the OEC procedure would undermine the ability of state regulatory commissions to subsidize the rates charged to residential and commercial customers through higher rates to industrial users, "a matter of essentially local concern" (Pet. App. 127a). He also disagreed with the majority's conclusion that the Commission had adequately justified its change in policy concerning bypass (*id.* at 127a-128a).

of the NGA to remedy undue discrimination, and that this general authority was properly implemented through the Commission's broad power to impose conditions upon certificates of convenience and necessity issued under Section 7 and its power under Section 16 of the NGA to "prescribe * * * rules * * * necessary or appropriate to carry out the [NGA's] provisions" (15 U.S.C. 717*o*). Petitioners do not dispute either the existence of the practices the Commission found or the Commission's finding that they are unduly discriminatory; rather they claim (87-976 Pet. 7-17; 87-977 Pet. 5-20; 87-979 Pet. 12-26) only that the open-access condition is beyond the Commission's authority because it amounts to the imposition of common carrier status. That claim is without merit and was properly rejected by the court below.

a. The Commission's broad remedial authority under the Natural Gas Act fully supports the imposition of the open-access condition as a remedy for the unlawful discrimination found by the Commission. As the court of appeals observed (Pet. App. 26a), the Natural Gas Act "fairly bristles with concern for undue discrimination." Section 4(b) of the NGA, 15 U.S.C. 717c(b), states that pipelines are "prohibited," in "any transportation" under the Commission's jurisdiction, from (1) "grant[ing] any undue preference or advantage," (2) imposing any "undue preference or disadvantage," or (3) "maintain[ing] any unreasonable differences in rates, charges, services, facilities, or in any other respect." Where the Commission finds that any transportation "practice" by a pipeline is "unduly discriminatory" or "preferential," Section 5(a) of the NGA specifically authorizes—indeed, requires—the Commission to "determine" the practice "to be thereafter observed" by the pipeline (15 U.S.C. 717d(a)). The court below correctly

recognized that "in the NGA Congress * * * [gave] the Commission power to stamp out undue discrimination; it is precisely that power that the Commission has here sought to exercise" (Pet. App. 26a).

The Commission chose to eradicate the unlawful discrimination in this case through its power under Section 7(e) of the NGA, 15 U.S.C. 717f(e), to attach conditions to certificates of public convenience and necessity issued under Section 7(c), 15 U.S.C. 717f(c). Under the open-access condition, pipelines that accept a blanket certificate, and thereby gain the self-implementing authority to transport gas without obtaining prior Commission approval, must agree to provide that transportation service "without undue discrimination or preference." 18 C.F.R. 284.8 (b), 284.9(b). Because the Commission does not review particular transactions under a blanket certificate, the open-access condition provides a necessary "bond of protection" (see *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 385 (1959)) against the continuation of the pipelines' unlawful practices. With this carefully crafted measure, therefore, the Commission fulfilled its statutory responsibility to eliminate undue discrimination.

Nothing in the language of the NGA supports petitioner's claim that the open-access condition somehow falls outside the Commission's statutory authority to remedy discrimination. Petitioners instead base their argument entirely upon ambiguous legislative history. That effort, as the court of appeals noted, is "uphill" because " 'courts have no authority to enforce principles gleaned solely from legislative history that has no statutory reference point.' " Pet. App. 25a (citation omitted); see also, *e.g.*, *United States* v. *Locke*, 471 U.S. 84, 95-96 (1985). And the history discussed by petitioners does not support their at-

tempt to restrict the Commission's express statutory authority (see Pet. App. 25a-26a).

The legislative history on which petitioners rely consists of congressional inaction: Congress several times considered, but failed to enact, provisions that would have imposed common carrier status on pipelines (Pet. App. 25a, 26a). As the court of appeals observed, the history at most provides "modest support" for the conclusion that Congress, having declined to impose such a generic rule itself, did not intend the Commission to impose common carrier status "at will" (*id.* at 26a). It suggests no reason at all why the Commission may not impose an open access condition in appropriate factual circumstances as a remedy for undue discrimination and anti-competitive behavior.

The open-access condition, by requiring that pipelines that provide certain transportation services must do so without undue discrimination, serves one of the same purposes as common carriage regulation (Pet. App. 25a-26a). But the open-access condition does not rest on any supposed general power to impose common carrier status but on the power to remedy discrimination under Sections 4, 5, and 7 of the NGA. Therefore, even assuming that Congress intended to preclude the Commission from mandating common carriage "at will," it does not follow that Congress also intended to preclude the Commission from imposing service obligations when necessary to remedy undue discrimination in the "extreme factual circumstances" (Pet. App. 30a) of this case.

Indeed, the legislative history suggests, if anything, that Congress withheld generic common carriage authority because the Commission's remedial authority under Sections 4 and 5 already provided a more precise regulatory tool that could be applied in appropri-

ate factual circumstances.[11] As the court of appeals observed (Pet. App. 26a-27a):

> The issue seems to come down to this: Although Congress explicitly gave the Commission the power and the duty to achieve one of the prime goals of common carriage regulation (the eradication of undue discrimination), the Commission's attempted exercise of that power is invalid because Congress, in 1906 and 1914 and 1935 and 1938 itself, refrained from affixing common carrier status directly onto the pipelines and from authorizing the Commission to do so. And this proposition is said to control no matter how sound the Order may be as a response to the facts before the Commission. We think this turns statutory construction upside down, letting the failure to grant a general power prevail over the affirmative grant of a specific one.

In sum, the legislative background relied upon by petitioners provides "weak—almost invisible—support" (Pet. App. 26a) for their attempt to read out of the statute the Commission's express authority to remedy undue discrimination. Because petitioners have failed to establish anything close to the "clearly

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[11] Petitioners attempt (87-976 Pet. 12; 87-977 Pet. 12; 87-979 Pet. 23) to find a statutory basis for their claim in Section 7(a) of the Natural Gas Act. That provision sets out particular circumstances in which the Commission may order pipelines to enlarge their facilities in order to provide new service. But the open-access condition does not require pipelines to enlarge their facilities; it imposes non-discriminatory transportation obligations *to the limits of a pipeline's capacity to provide service.* See Pet. App. 42a-46a (discussing methods of allocating capacity when a pipeline has more requests for service than it can provide). Nothing in Section 7(a) limits the Commission's authority to require pipelines to provide transportation over existing facilities on terms that are not unduly discriminatory or anticompetitive.

expressed legislative intent" needed to overcome "the plain language of the statute" (*American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 75 (1982)), the court of appeals properly upheld the Commission's interpretation of its statutory authority as reasonable. Pet. App. 34a, citing *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).[12]

b. The court of appeals also correctly concluded (Pet. App. 34a-39a) that Section 602(b)(2) of the NGPA, 15 U.S.C. 3432(b)(2), poses no barrier to the imposition of the open-access condition upon pipelines that transport natural gas under Section 311 (b)(1) of that statute.[13]

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[12] Petitioner in No. 87-977 is mistaken in its claim (Pet. 7-8) that the court below expanded upon the Commission's own view of its authority by affirming the open-access condition while rejecting the Commission's justification that the condition was voluntary. The Commission, in responding to arguments that the open-access condition amounted to common carriage, first stated (50 Fed. Reg. 42427 (1985)) that the condition properly rested upon its statutory authority to remedy undue discrimination. Because the court affirmed on that basis (Pet. App. 24a-39a), it did not reach the question whether that condition might also be justified as voluntary. Rather, the court addressed the Commission's claim that Order No. 436 was voluntary in a different context and rejected it there for reasons that have nothing to do with the common carriage arguments (see page 14 & n.8, *supra*).

[13] Section 602(b), entitled "Effect on State laws," provides:

> No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—
>
> (1) pursuant to any [presidential] order under section 3362(c) or section 3363(b), (c), (d), or (i) of this title; or
>
> (2) authorized by the Commission under section 3371(a) of this title.

The court held that Section 602(b) "was a congressional effort to protect § 311(a) from the consequences of pipeline concern that service thereunder would expose them generally to classification as common carriers, most likely by states, and thus to an unprecedented range of legal burdens" (Pet. App. 35a). Without such protection, pipelines might be discouraged from transporting gas under the NGPA, thus defeating "the accomplishment of Congress's purposes" (*id.* at 35a-36a).[14] The court found no indication in the overall statutory scheme of the NGPA that Section 602(b) was intended to limit the Commission's authority to regulate transportation activities under Section 311. Indeed, Section 311(c) specifically states that transportation under that provision "shall be under such terms and conditions as the Commission may prescribe" (15 U.S.C. 3371(c)). To the extent Section 602(b) is relevant at all, it is because Congress foresaw the possibility that the Commission might exercise Section 311(c) authority to impose conditions resembling common carriage. Section 602(b) affirmatively protects a pipeline that decides to provide transportation under those conditions from any possibility that its actions might trigger the imposition of common carrier status under other statutes.

The structure of Section 602(b) supports this interpretation. The provision contains parallel subsections that protect pipelines from common carriage laws "by reason of any transportation" under either (1) presidential orders in emergency situations (see 15 U.S.C. 3432(b)(1)) or (2) Commission authori-

[14] The court noted (Pet. App. 36a) that "[t]hough we have not identified similar federal hazards, we believe that Congress might well have included the reference to federal law out of anxiety that some overlooked federal provision would operate to thwart § 311's purposes."

zation under Section 311(a) (see 15 U.S.C. 3432 (b)(2)). Noting that "[t]he President's emergency powers are extremely broad," the court below found it "hardly credible that § 602 would stand in the way" of the imposition by the President of duties similar to common carriage if such action were necessary in emergency conditions. "By the same token, that section must not flatly bar the Commission from imposing similar conditions on gas transportation under § 311." Pet. App. 37a.[15]

c. Contrary to petitioners' assertions (87-976 Pet. 7-9, 12-14; 87-977 Pet. 10-14; 87-979 Pet. 9-12, 21-26), no decision of this Court or of another court of appeals conflicts with the determination of the court below that the Commission has the authority to impose the open-access condition under the Natural Gas Act and the NGPA. The cases on which petitioners rely address attempts to impose common carriage-like requirements under other statutory schemes, none of which provided express statutory authority to remedy undue discrimination.

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[15] There is no basis for the claim (87-976 Pet. 14; 87-977 Pet. 9-10; 87-979 Pet. 6) that the Commission's interpretation of Section 602 in the present case conflicts with an earlier interpretation set forth in 44 Fed. Reg. 52179, 52180-52181 (1979). The matter before the Commission in the earlier case was a request that it compel interstate pipelines to provide transportation services to distributors under Section 311. The Commission found nothing in the statute or the legislative history indicating that it had authority to require the provision of such services. The Commission did not there address the issue in this case: the scope of its authority to require that pipelines *already providing* Section 311 transportation service do so without undue discrimination or anticompetitive behavior. Therefore, the Commission's determination in that proceeding does not conflict with its conclusion here (50 Fed. Reg. 42429 (1985)) that Section 602(b) "does not sweep so broadly as to license unduly discriminatory rates or practices."

First, petitioners err in relying (87-976 Pet. 7-9; 87-977 Pet. 5-6; 87-979 Pet. 9-12) upon this Court's decision in *FCC* v. *Midwest Video Corp.*, 440 U.S. 689 (1979). The Court held in that case that a rule promulgated by the Federal Communications Commission requiring operators of cable television systems to offer channels for public use was barred by Section 3(h) of the Communications Act, 47 U.S.C. 153 (h), which specifically prohibits the agency from treating broadcasters as common carriers. There is no such prohibition in either the Natural Gas Act or the NGPA. Moreover, *Midwest Video* did not present the central question posed here—whether such a rule might be justified as a remedy for unduly discriminatory and anticompetitive practices. For these reasons the question addressed in *Midwest Video* does not at all resemble the issue in this case. See Pet. App. 27a.

Petitioners also seek to rely (87-976 Pet. 13-14; 87-977 Pet. 10-14; 87-979 Pet. 17-23) upon a series of cases involving Commission authority under the Federal Power Act, 16 U.S.C. (& Supp. IV) 791a *et seq.* In *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973), this Court upheld a lower court decision that an electric utility had violated the antitrust laws by refusing to transmit or "wheel" electric power. The Court rejected the utility's claim that its actions were immune from the antitrust laws because they were subject to regulation by the Commission under the Federal Power Act, holding that the Act gave the Commission only "limited" authority to order wheeling and left enough room for voluntary action by the utility to warrant application of the antitrust laws. 410 U.S. at 373-375.

Otter Tail Power Co. is plainly distinguishable from the present case. To begin with, the Federal Power Act does not give the Commission certificate

and abandonment authority over the interstate transmission of electricity; there is accordingly no equivalent to Section 7 of the Natural Gas Act, upon which the Commission based the open-access condition in this case. Second, as the court of appeals observed (Pet. App. 28a), the legislative history of the Federal Power Act discussed by this Court in *Otter Tail Power Co.* is "materially different" with respect to common carriage. When it adopted that statute, Congress considered and rejected a provision that would have specifically empowered the Commission to order wheeling to further the public interest. See *Otter Tail Power Co.*, 410 U.S. at 374. As we have discussed, Congress did not specifically eliminate the power to impose common carriage-like requirements at the time that it adopted the Natural Gas Act.[16]

These factors also distinguish the various decisions of the courts of appeals concerning the scope of the Commission's authority to order wheeling under the Federal Power Act (see 87-976 Pet. 13 n.12; 87-977 Pet. 12-14; 87-979 Pet. 21-25). Moreover, none of those cases presented the question whether the Commission could order wheeling to remedy undue discrimination or anticompetitive behavior (see Pet. App. 28a-30a).[17] The decision in this case therefore

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[16] Petitioners in No. 87-979 argue (Pet. 18-20) that the legislative histories of the two statutes are identical, but they rely on the provisions of a 1935 bill that was never reported out of committee (see Pet. App. 25a). Because the entire bill simply died in committee without being reported, it is impossible to conclude that Congress intended to limit the Commission's broad remedial authority. This legislative history is plainly different from that of the Federal Power Act, where Congress specifically deleted the relevant provisions at the time it adopted the statute and explained that it was doing so in order to limit the Commission's authority.

[17] In *Florida Power & Light Co.* v. *FERC*, 660 F.2d 668, 677-678 (5th Cir. 1981), cert. denied, 459 U.S. 1156 (1983),

does not conflict with the decisions cited by petitioners.

2. Other petitioners, producers of natural gas, claim (87-978 Pet. 9-23) that the court of appeals erred in remanding Order No. 436 to the Commission for reconsideration of the take-or-pay issue. The court of appeals held (Pet. App. 94a) that the Commission failed to provide a sufficient explanation of its decision to take no affirmative action to alleviate problems allegedly caused by take-or-pay contracts. In the view of these petitioners (87-978 Pet. 12, 15-21), the Commission sufficiently explained that decision in Order No. 436 and the court should have affirmed. This claim does not justify review by this Court.

The question whether the Commission sufficiently considered the take-or-pay question in Order No. 436 has absolutely no significance beyond this case. Indeed, these petitioners appear to be motivated by concern that the Commission might adopt one of the proposed solutions to the take-or-pay problem that

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the court specifically reserved the question whether the Commission could order wheeling to remedy undue discrimination (see Pet. App. 27a-28a). In a somewhat different vein, the court in *New York State Electric & Gas Corp.* v. *FERC*, 638 F.2d 388 (2d Cir. 1980), cert. denied, 454 U.S. 821 (1981), held that, where Congress had specified certain procedural and substantive prerequisites before the Commission may order wheeling (see 16 U.S.C. (& Supp. IV) 824j, 824k), the Commission must satisfy those prerequisites before requiring wheeling as a remedy for anticompetitive behavior. The Natural Gas Act does not contain any procedural prerequisites applicable in the present case.

Finally, petitioner in No. 87-979 errs in claiming (Pet. 21-23) that the decision by the court of appeals in this case conflicts with the decision in *Central West Utility Co.* v. *FPC*, 247 F.2d 306 (3d Cir. 1957). That case involved limitations imposed by Section 7(a) of the Natural Gas Act; as noted above (see note 11, *supra*), that provision does not apply to the open-access condition.

the court of appeals directed the Commission to reconsider on remand. But the propriety of those solutions may be considered in review proceedings following the Commission's decision with respect to this question.[18]

3. Although the optional expedited certificate rules were challenged in the court of appeals by a large number of parties, only one local distribution company, Southern California Gas Company (SoCalGas), has raised the matter in this Court (No. 87-1091). And SoCalGas merely renews arguments that the court below properly rejected either on the merits or on the ground that the claims were premature and hypothetical.

a. SoCalGas argues, as it did in the court of appeals, that the Commission has "turn[ed] its back" on the standards of Section 7 of the Natural Gas Act by adopting a presumption that the public convenience and necessity will be satisfied if a proposal is structured in accordance with specified standards (87-1091 Pet. 5-7); that the OEC rules represent an unjustified and unexplained departure from the Commission's "historic policy" of discouraging pipelines from "bypassing" local distribution companies in order to directly serve industrial customers (*id.* at 7-9); and that the OEC rules are invalid because they will

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[18] Petitioners are mistaken in suggesting (Pet. 9, 17) that the mandate of the court of appeals binds the Commission's discretion on remand. On the contrary, the court below specifically declined to direct any particular course of action on remand (Pet. App. 92a, 94a) and expressly preserved the possibility that the Commission might reaffirm its decision regarding the take-or-pay issue (*id.* at 94a). Indeed, the latter aspect of the majority's decision drew a dissent from Judge Mikva who stated (*id.* at 126a) that the Commission should be required to take affirmative action respecting the take-or-pay issue.

require the Commission to approve such bypass arrangements without giving due consideration to the impact on captive customers (*id.* at 14-15). None of these claims has any merit and each was properly rejected by the court of appeals.

In the first place, as the court of appeals noted, it is "far too late in the history of administrative law" to suggest that a regulatory agency cannot establish by rulemaking the criteria it will apply in evaluating whether to grant certificate authority. Pet. App. 102a-103a n.34, citing *FPC* v. *Texaco Inc.*, 377 U.S. 33 (1964); *United States* v. *Storer Broadcasting Co.*, 351 U.S. 192 (1956); and *National Tour Brokers Ass'n* v. *ICC*, 671 F.2d 528 (D.C. Cir. 1982).

The court of appeals thoroughly considered—and properly rejected—petitioner's challenges to the merits of the rule (see Pet. App. 102-111a). The court found (*id.* at 104a) that because the criteria selected by the Commission promote competition in the interstate transportation of natural gas, they must be viewed as "an experiment designed to realize the congressional scheme, not to defeat it." In addition, because the rules place all economic risk on the pipeline seeking the optional certificate, they do not depart from the Commission's traditional policy against bypass, which essentially sought to avoid burdening consumers with costs attributable to unnecessary duplication of facilities (*id.* at 111a-112a).

Finally, petitioner's claim that the rules preclude adequate consideration of the effects of bypass on "captive" customers is undercut by provisions in the rules themselves requiring actual notice by the OEC applicant to affected local distribution companies and state statutory agencies. 18 C.F.R. 157.102(b)(1)(iv). Moreover, the court of appeals found that re-

lief on a bypass claim might well be available from state regulators (Pet. App. 105a-111a).[19]

b. SoCalGas also argues (Pet. 9-10) that its complaints about the procedures set forth in the OEC rules—*i.e.*, that the rules impermissibly shift the burden of proof from the applicant to opposing parties, and that the presumption established by the rules will be "conclusive" in practice and not rebuttable—are ripe for review.

The court of appeals correctly determined, under the two-pronged test of *Abbott Laboratories* v. *Gardner*, 387 U.S. 136 (1967), that these procedural challenges are not ripe for review. First, by their very nature, complaints about burden of proof and the operation of presumptions will be better illuminated in a concrete factual setting. See Pet. App. 100a-101a. Furthermore, SoCalGas faces no immediate harm as a result of the postponement of review; nor is it called upon to change its "primary conduct" in reliance on the rules, see *Toilet Goods Ass'n* v. *Gardner*, 387 U.S. 158 (1967). See Pet. App. 101a-102a. There will be an opportunity, on review of any decision granting a certificate under the OEC procedure, for SoCalGas to challenge the Commission's application of the new rules.

In any event, SoCalGas's premise is false: the presumption established by the rules need not be "conclusive" (87-1091 Pet. 10). As the court of appeals stated (Pet. App. 109a (emphasis added)):

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[19] Moreover, this claim regarding the consideration to be devoted to bypass claims under the Commission's new procedures, like the other procedural challenges raised by petitioner, is best left for resolution until after the OEC rules are applied in a concrete factual situation. See pages 29-30, *infra*.

the presumption created by the OEC procedures *is* rebuttable. We cannot know at this point precisely what will be necessary to persuade the Commission that application of the presumption is inappropriate. But the existence of that backdrop confirms our judgment that the OEC rules themselves can readily be applied in a manner consistent with the congressional purposes.

c. Petitioner also argues (87-1091 Pet. 11-14) that because the Commission and the court of appeals assumed that states retain authority to regulate local aspects of bypass under *Panhandle Eastern Pipe Line Co.* v. *Michigan Public Service Comm'n*, 341 U.S. 329 (1951), this Court should now "clarify" the exact scope of such state authority to ensure that a "regulatory gap" does not result from the OEC rules.

This Court held in *Panhandle* that a state regulatory commission could assert certificate authority over local facilities proposed by a pipeline company to directly serve industrial customers already being served by a local distribution company. SoCalGas would have this Court go much further, and provide guidance on the precise reach of state authority under *Panhandle*.[20] But this Court "do[es] not sit to decide hypothetical issues or to give advisory opinions about issues as to which there are not adverse parties before [it]." *Princeton Univ.* v. *Schmid*, 455 U.S. 100, 102 (1982).

[20] The court of appeals acknowledged that the "exact scope" of the states' authority to regulate local aspects of bypass is "unplumbed," but concluded that the issue was not properly before the court, and that, in any event, the *Panhandle* case "clearly tends to undermine petitioners' assault on the Commission's refusal to except bypass situations from the OEC procedures, insofar as that assault turns on assumptions of total state incapacity to address the issue" (Pet. App. 106a).

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

(Other cases listed on inside cover)

On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

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TEXAS EASTERN TRANSMISSION CORPORATION,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

CITY OF WILLCOX, ARIZONA, and
ARIZONA ELECTRIC POWER COOPERATIVE, INC.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

SOUTHERN CALIFORNIA GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

QUESTIONS PRESENTED

1. Whether the petitions for writ of certiorari are moot as to the vacated Order 436 program and premature as to the still non-final successor program (Order 500)?

2. Whether the Federal Energy Regulatory Commission ("FERC") acted within its authority under the Natural Gas Act and the Natural Gas Policy Act of 1978 ("NGPA") to prohibit undue discrimination among potential customers as a condition for a pipeline's receiving *blanket, self-implementing* authorizations to transport natural gas for others in interstate commerce?

3. Whether FERC's imposition of an antidiscrimination condition upon a voluntary, self-implementing blanket transportation program unlawfully requires pipelines to become "common carriers" when pipelines remain free to apply for individual certificates of public convenience and necessity on a traditional, case-by-case basis?

4. Whether Southern California Gas Company's challenge to the optional expedited certificate ("OEC") procedure is unripe given that the OEC procedure has not injured, and may never injure, Petitioner or anyone else by permitting a so-called "bypass" of Petitioner's or anyone else's local distribution company system?

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF AUTHORITIES	iv
STATEMENT OF THE CASE	1
REASONS FOR DENYING PETITIONS	5
I. Certiorari Must Be Denied Because Petitioners' Claims Are Moot and/or Premature	5
II. No Basis Exists for Further Review of FERC's Imposition of an Antidiscrimination Condition Upon its Offer to Pipelines of Blanket, Self-Implementing Transportation Authority	9
A. Adoption of the Nondiscrimination Condition Was Both Lawful and Appropriate	9
B. FERC's Nondiscriminatory Access Condition Is Neither Compulsory Nor Does It Require Gas Pipelines to Transport Gas As Common Carriers	16
C. NGPA Section 602(b)(2) Was Not Designed to Restrain FERC from Imposing Nondiscriminatory Access Conditions on Blanket Transportation Authorizations	20
D. Midwest Video is Neither Relevant Nor Controlling	24
III. SoCal's Challenges to the Optional Expedited Certificate Regulations do not Warrant a Writ of Certiorari	26
A. SoCal's Challenges are Premature	26
B. The OEC Regulations Are Within FERC's Statutory Authority	27
C. There Is No Jurisdictional Conflict	29
CONCLUSION	30
APPENDIX A	

TABLE OF AUTHORITIES

CASES: Page

Abbott Laboratories v. Gardner, 387 U.S. 136 (1967) 8
Alabama-Tennessee Natural Gas Co. v. FPC, 203 F.2d 494 (3d Cir. 1953) 11
Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987) ..... 1, 6, 12, 13, *passim*
Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378 (1959) 10, 11
California v. FPC, 296 F.2d 348 (D.C. Cir. 1961) 14
Center for Science in the Public Interest v. Regan, 727 F.2d 1161 (D.C. Cir. 1984) 8
City of Pittsburgh v. FPC, 237 F.2d 741 (D.C. Cir. 1956) 14
Columbia Broadcasting System, Inc. v. Democratic National Committee, 412 U.S. 94 (1973) .. 25
EPA v. Brown, 431 U.S. 99 (1977) 8
FCC v. Midwest Video Corp., 440 U.S. 689 (1979) 24
FPC v. Conway Corp., 426 U.S. 271 (1976) 14
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) 11
Gulf States Utilities Co. v. FPC, 411 U.S. 747 (1973) 14
Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) 14, 15
Maryland People's Counsel v. FERC, 761 F.2d 780 (D.C. Cir. 1985) 5, 13, 15
Maryland People's Counsel v. FERC, 768 F.2d 1354 (D.C. Cir. 1985) 5
Michigan Consolidated Gas Co. v. FPC, 203 F.2d 875 (3d Cir. 1953) 12
Office of Consumers' Counsel v. FERC, 783 F.2d 206 (D.C. Cir. 1986) 23
Pennsylvania Railroad v. Sonman Shaft Coal Co., 242 U.S. 120 (1916) 17

TABLE OF AUTHORITIES—Continued

Page

Permian Basin Area Rate Cases, 390 U.S. 747 (1968) 16
Red Lion Broadcasting Co. v. FCC, 395 U.S. 367 (1969) 25
Southern Pacific Terminal Co. v. Interstate Commerce Commission, 219 U.S. 498 (1911) 8
Tennessee Gas Pipeline Co. v. FERC, 689 F.2d 212 (D.C. Cir. 1982) 11
Transcontinental Gas Pipe Line Corp. v. FERC, 589 F.2d 186 (5th Cir. 1979), *cert. denied*, 445 U.S. 915 (1980) 11
United Gas Pipe Line Co. v. Mobile Gas Serv. Corp., 350 U.S. 332 (1946) 19
United States v. Contract Steel Carriers, 350 U.S. 409 (1956) 18
United States v. Midwest Video Corp., 406 U.S. 649 (1972) 25

AGENCY DECISIONS AND ORDERS:

Order No. 234-B, [1982-1985] FERC Stats. & Regs. Preambles (CCH) ¶ 30,476 (1983) 4
Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 *Fed. Reg.* 42,408 (Oct. 18, 1985), 1982-1985 FERC Stats. & Regs. Preambles (CCH) ¶ 30,665 (1985); Order No. 436-A, 50 *Fed. Reg.* 52,217 (Dec. 23, 1985), 1982-1985 FERC Stats. & Regs. Preambles (CCH) ¶ 30,675 (1985); Order No. 436-B, 51 *Fed. Reg.* 6,398 (Feb. 24, 1986), III FERC Stats. & Regs. Preambles (CCH) ¶ 30,688 (1986); Order No. 436-C, 51 *Fed. Reg.* 11,566 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,404 (1986); Order No. 436-D, 51 *Fed. Reg.* 11,569 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,405 (1986); Order No. 436-E, 51 *Fed. Reg.* 11,566 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,403 (1986) ..... 1, 12, 13, 17, *passim*

TABLE OF AUTHORITIES—Continued

Page

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American Distribution Company, 37 FERC (CCH) ¶ 61,282 (December 23, 1986) 28, 29

Belle Fourche Pipeline Co., 28 FERC (CCH) ¶ 61,150 (July 26, 1984) 19

El Paso Natural Gas Co., 35 FERC (CCH) ¶ 61,440 (1986), *reh. denied*, 38 FERC (CCH) ¶ 61,008 (1987) 19

Moraine Pipeline Company, 42 FERC (CCH) ¶ 61,144 (February 2, 1988) 27, 29

Northwest Alaskan Pipeline Co., 3 FERC (CCH) ¶ 61,226 (June 7, 1978) 18

Powder River Pipeline Corp., 4 FERC (CCH) ¶ 61,338 (September 22, 1988) 19

Powder River Pipeline Corp. v. Amoco Pipeline, 10 FERC (CCH) ¶ 61,044 (January 15, 1980) .. 19

Texas Eastern Transmission Corp., 41 FERC (CCH) ¶ 61,015 (1987), *appeal docketed, Texaco, Inc. v. FERC*, No. 87-4735 (5th Cir., filed Oct. 15, 1987); *Texas Eastern Transmission Corp. v. FERC*, No. 87-1774 (D.C. Cir. filed Dec. 15, 1987) 20

Transcontinental Gas Pipe Line Corporation, 33 FPC 237 (1965) 28

Wyoming-California Pipeline Company, 52 *Fed. Reg.* 23,266 (June 26, 1986) 27

TABLE OF AUTHORITIES—Continued

HEARINGS AND REPORTS: Page

123 CONG. REC. H.8382 (August 3, 1977) (Daily Edition) 22
H. REP. No. 590, 95th Cong., 1st Sess. (1977) 18
H. REP. No. 1474, 95th Cong., 2d Sess. 87 (1978) .. 18
National Energy Act, Report of the Ad Hoc Committee on Energy, U.S. House of Representatives, on H.R. 8444, Rep. No. 95-543, 95th Cong., 1st Sess. 45 (1977) 21
S. REP. No. 207, 93rd Cong., 1st Sess., *reprinted in* [1973] *U.S. Code Cong. & Ad. News* 2417.... 17

FEDERAL STATUTES:

Act of March 19, 1918,
15 U.S.C. § 261 (1982) 21
Alaska Natural Gas Transportation Act, § 13(a),
15 U.S.C. § 717 (1982) 18
Clayton Act, § 10,
15 U.S.C. § 20 (1982) 21
Communications Act of 1934,
47 U.S.C. § 151 (1982) 24
Employers' Liability Act, § 10,
45 U.S.C. § 60 (1982) 21
Foreign Intelligence Surveillance Act of 1978, § 105,
50 U.S.C. § 1805 (1982) 21
Mineral Leasing Act, § 185(r),
30 U.S.C. § 185r (1982) 17
Natural Gas Act,
15 U.S.C. §§ 717-717w (1982) 2, 10, 11, 25
Natural Gas Policy Act of 1978,
15 U.S.C. §§ 3301-3432 (1982) 2, 14, 15, 25
Postal Reorganization Act, § 603,
39 U.S.C. § 603 (1982) 21

TABLE OF AUTHORITIES—Continued

Page

Powerplant and Industrial Fuel Use Act of 1978, § 731,
15 U.S.C. § 8441(f) (1982) 22

Public Utility Regulatory Policies Act of 1978, § 606,
15 U.S.C. § 717y (1982) 22

The Outer Continental Shelf Lands Act Amendments of 1978,
30 U.S.C. § 1334F (1982) 18

Tariff Act of 1930, § 551,
19 U.S.C. § 1551 (1982) 21

STATE STATUTES:

MICH. COMP. LAWS ANN. § 483.110 (West 1979) 21

REGULATIONS:

18 C.F.R. § 284.7 (1987) 19
18 C.F.R. § 284.8 (1987) 7, 9
18 C.F.R. § 284.9 (1987) 7, 9
18 C.F.R. § 284.10 (1987) 20

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

Nos. 87-976, *et al.*

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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RESPONDENTS' BRIEF IN OPPOSITION

Respondents the Process Gas Consumers Group ("PGC"), the American Iron and Steel Institute ("AISI"), and The Fertilizer Institute ("TFI") respectfully request that this Court deny the Petitions for Writ of Certiorari sought herein in Docket Nos. 87-976, 87-977, 87-979, and 87-1091 to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987); J.A. at 124a.

STATEMENT OF THE CASE

Federal Energy Regulatory Commission ("FERC") Order No. 436,[1] challenged here by Petitioners, offers

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[1] Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 50 Fed. Reg. 42,408 (Oct. 18, 1985), 1982-1985 FERC Stats. & Regs. Preambles (CCH) ¶ 30,665 (1985); Order No. 436-A, 50 Fed. Reg. 52,217 (Dec. 23, 1985), 1982-1985 FERC Stats. & Regs. Preambles (CCH) ¶ 30,675 (1985); Order No. 436-B, 51 Fed. Reg. 6,398 (Feb. 24, 1986), III FERC Stats. &

natural gas pipelines that seek approval to transport gas for others in interstate commerce an alternative to the traditional certification procedures that have been utilized since the enactment of the Natural Gas Act ("NGA") in 1938.[2] Order No. 436 offers pipelines an option to obtain "blanket", self-implementing transportation authority, pursuant to Section 311[3] of the Natural Gas Policy Act of 1978 ("NGPA")[4] and Section 7(c) of the NGA,[5] to transport natural gas for others without traditional case-by-case FERC review. In return for such a broad grant of authority, a pipeline must agree to implement certain rate and tariff conditions and to provide transportation authorized by Order 436 on a nondiscriminatory basis. Pipelines that are unwilling to comply with the rule's protections against unduly discriminatory and anticompetitive conduct remain free to utilize traditional NGA Section 7(c) individual certificate procedures.

Petitioners[6] ask this Court to eliminate Order No. 436's nondiscrimination requirement for blanket transportaton authority. Since no petitioner disputes FERC's authority to approve a properly conditioned blanket transportation program, it appears that Petitioners are asking for blanket authority to transport third parties' gas while retaining the absolute freedom to pick and

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Regs. Preambles (CCH) ¶ 30,688 (1986); Order No. 436-C, 51 Fed. Reg. 11,566 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,404 (1986); Order No. 436-D, 51 Fed. Reg. 11,569 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,405 (1986); Order No. 436-E, 51 Fed. Reg. 11,566 (Apr. 4, 1986), 34 FERC (CCH) ¶ 61,403 (1986).

[2] Natural Gas Act, 52 Stat. 821, 15 U.S.C. §§ 717-717w (1982).

[3] 15 U.S.C. § 3371 (1982).

[4] 15 U.S.C. §§ 3301-3432 (1982).

[5] 15 U.S.C. § 717f(c) (1982).

[6] The Interstate Natural Gas Association of America ("INGAA"), the City of Willcox, Arizona and the Arizona Electric Power Cooperative, Inc. (jointly "AEPCO") and Texas Eastern Transmission Corporation ("TETCO") (collectively "Petitioners").

choose among prospective shippers without any regulatory restaint on anticompetitive or unduly discriminatory practices.

The need for blanket, self-implementing transportation authority has not been caused by regulatory changes initiated by FERC, but instead arises from profound market changes in the natural gas industry subsequent to the enactment of the NGPA. The fundamental factor giving rise to this need was the emergence, as a result of pipeline post-NGPA purchasing practices, of a natural gas market plagued by rising prices at the burnertip (*i.e.*, the point of use) even as a natural gas surplus continued to grow and the price of competing fuels declined. Consequently, consumers and local distribution companies ("LDCs") sought access to transportation for gas that they purchased directly from producers, and many producers sought access to transportation in order to sell their gas. For their part, pipelines generally favored self-implementing transportation as a means to preserve markets—and revenue—that might otherwise be lost in an increasingly competitive marketplace.

FERC's extensive rulemaking record demonstrates that all segments of the industry recognize the desirability of self-implementing, blanket transportation authority. Unlike FERC's traditional practice of reviewing individual proposed transactions on a case-by-case basis to determine whether the public convenience and necessity would be served by the transaction—a process which may take months or longer—a blanket certificate provides authority for initiation of new transportation arrangements and termination of old transactions without further regulatory action. As a result, a pipeline can react to market demand for transportation of third-party gas as it arises, not after the delays inherent in traditional regulatory review.

FERC designed the Order No. 436 regulations based on two years of experience with prior blanket transporta-

tion programs, judicial guidance, and an extensive rulemaking record of unduly discriminatory and anticompetitive transportation practices by interstate pipelines. FERC's first attempt to implement a broad blanket transportation program, Order No. 234-B,[7] was riddled with discriminatory and anticompetitive behavior by natural gas pipelines. Although the Order No. 234-B program, in the context of FERC's overall transportation programs, was facially neutral, interstate pipelines generally implemented the program in an anticompetitive and discriminatory manner by transporting market-priced gas solely to fuel-switchable users and local distributors that already had low-priced alternatives, while refusing to transport natural gas that would compete with their own high-priced sales to captive markets. Consequently, "captive" customers—those without alternative fuel or other gas supplies—were restricted to more expensive pipeline-owned gas supplies at the same time that interstate pipelines willingly transported less expensive gas sold by producers and independent marketers to noncaptive customers.

In 1985, the U.S. Court of Appeals for the District of Columbia Circuit vacated the Order No. 234-B blanket transportation rule because it failed to guard against unduly discriminatory and anticompetitive transportation practices by interstate pipelines. The court cited the Natural Gas Act's explicit ban on undue discrimination, FERC's duty to protect consumers from exploitation by natural gas companies, and its obligation to consider antitrust policies. The court held that the program would have to terminate unless the Commission either (a) conditioned the blanket certificates granted by that rule upon a pipeline's performance of nondiscriminatory transportation, or (b) justified a decision not to include

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[7] Order No. 234-B, 48 Fed. Reg. 34,872 (Aug. 1, 1983), 1982-1985 FERC Stats. & Regs. Preambles (CCH) ¶ 30,476 (July 20, 1983).

such a condition.[8] The *MPC* court subsequently stayed its mandate until October 31, 1985,[9] in order to afford FERC time to complete rulemaking proceedings which culminated in Order No. 436.

In addition to the centerpiece of blanket, self-implementing transportation, Order No. 436 also established a new optional expedited certification ("OEC") procedure to authorize new sales and transportation services and related facilities. A broad range of new services may be authorized by the OEC regulations, including interstate pipeline sales or transportation service to other pipelines, local distribution companies, or end users. In return for pipeline agreement to provide certain safeguards designed to protect its ratepayers, including acceptance of the full risk of the transaction, the OEC regulations provide a rebuttable presumption that the proposed service or facility is in the public interest. Unless that presumption is rebutted by a protesting party, the FERC may grant a certificate without lengthy formal administrative proceedings. Petitioner Southern California Gas Company attacks the OEC regulations based on the possibility that at some future time a pipeline may seek to use the procedures to "bypass" a local distribution company and provide service directly to an end user. No such bypass has occurred, however, pursuant to an OEC certificate during the nearly two and one-half years since the regulations were promulgated.

REASONS FOR DENYING THE PETITIONS

I. CERTIORARI MUST BE DENIED BECAUSE PETITIONERS' CLAIMS ARE MOOT AND/OR PREMATURE.

The target of Petitioners' complaints—FERC Order Nos. 436, *et seq.*—was *vacated* by the court of ap-

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[8] Maryland People's Counsel v. FERC, 761 F.2d 780, 788-89 (D.C. Cir. 1985) ("*MPC II*").

[9] Maryland People's Counsel v. FERC, 768 F.2d 1354 (D.C. Cir. 1985).

peals,[10] and FERC has not petitioned for further judicial review in order to preserve these orders. Instead, FERC returned to the drawing board to design a new blanket transportation rule responsive to the D.C. Circuit's decision—an action which it has not yet completed. Pending development of the new final rule, FERC promulgated interim blanket transportation regulations.[11] This action was necessary to prevent virtual chaos in the natural gas industry, which would have resulted from termination of ongoing transportation arrangements.

While the Order No. 500 interim rules repromulgate most of the Order No. 436 regulations, there are changes in the antidiscrimination rules which, *inter alia*, limit the scope of participating pipelines' transportation obligations with respect to gas sold by producers that have ongoing take-or-pay claims. Thus, Petitioners' arguments for a writ of *certiorari* reflect either (1) a moot challenge to Order Nos. 436, *et seq.* or (2) a premature and misplaced challenge to Order Nos. 500, *et seq.*[12]

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[10] Associated Gas Distributors v. FERC, 824 F.2d 981, 1044 (D.C. Cir. 1987); J.A. at 124a (*"AGD"*).

[11] Order No. 500, Interim Rule and Statement of Policy, 52 Fed. Reg. 30,334 (August 14, 1987), III FERC (CCH) ¶ 30,761 (1987); Order No. 500-A, 52 Fed. Reg. 39,507 (October 22, 1987), III FERC (CCH) ¶ 30,770 (1987); Order No. 500-B, 52 Fed. Reg. 39,630 (October 23, 1987), III FERC (CCH) ¶ 30,772 (1987); Order No. 500-C, 52 Fed. Reg. 48,986 (December 29, 1987), III FERC (CCH) ¶ 30,786 (1987); Order 500-D, Docket Nos. RM87-34-000 through 053, issued March 8, 1988; *appeals docketed sub noms.* American Gas Association v. FERC, No. 87-1588 (D.C. Cir. Oct. 19, 1987); Shell Offshore, Inc. and Shell Western E&P, Inc. v. FERC, No. 87-4749 (D.C. Cir. Oct. 19, 1987).

[12] AEPCO goes further and implicitly seeks judicial review of FERC orders in other unspecified dockets. For example, to buttress its arguments AEPCO claims that the FERC has uniformly applied "open access" requirements to individual NGA Section 7(c) certificates issued after Order No. 436. No such requirement is imposed by Order No. 436, and there is no basis in the record for such a claim. If AEPCO has a dispute, it must seek relief, if at all, on

Petitioners' claim that the Order No. 436 rules survive the Circuit Court's mandate is wrong: the Commission has not promulgated any final rule on remand, and the interim rules differ in significant respects from the rules challenged here. Although most of Order 436 has been repromulgated in the interim rules, the new interim regulations—which, thus far, are embodied in Order Nos. 500, 500-A, 500-B, 500-C and 500-D—have added a new subsection [13] which allows pipelines to choose to deny transportation of certain producers' gas unless the pipeline receives concessions regarding outstanding take-or-pay liabilities.[14] This new provision responds to the pipelines' major concern in the original rulemaking, and it substantially limits the so-called "open access" condition promulgated by Order No. 436 by giving pipelines an element of choice as to whose gas will be transported under the blanket authority.

In light of the fact that Order No. 436 no longer exists and the as-yet-interim successor rules limit the condition about which the Petitioners complain, Petitioners' claims are moot as to Order No. 436 and premature as to Order No. 500. The FERC has agreed to make modifications responsive to the D.C. Circuit's decision and is

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review of those individual certificate orders. Similarly, complaints against the Order No. 500 interim rule must be resolved in the proceedings already underway to review that order. *See* n.11, *supra*.

[13] To be codified at 18 C.F.R. §§ 284.8(f) and 284.9(f); *see* App. A at 3a-10a, 11a-18a.

[14] In so circumscribing the "open access" regulations, FERC followed the suggestions of two of the petitioners herein, INGAA and TETCO. *See* Comments of the Interstate Natural Gas Ass'n of America, FERC Docket No. RM85-1-000 at 13, 17 (filed July 15, 1985) (R. 4753, 4757); Comments of Texas Eastern Transmission Corp., FERC Docket No. RM85-1-000 at 23 (filed July 15, 1985) (R. 2405); Initial Brief of Texas Eastern Transmission Corp. in Associated Gas Distributors v. FERC, No. 85-1811 at 6 (D.C. Cir., filed May 30, 1986). These Petitioners cannot legitimately claim that the unmodified "open access" provisions are ripe for review at this time.

in the process of doing so. The crux of Petitioners' problem, then, appears to be that they are unhappy that the D.C. Circuit did not prohibit any imposition of an antidiscrimination condition upon a blanket transportation program as being beyond FERC's statutory authority. However, delimiting FERC's authority in the abstract is not the appropriate function of Supreme Court review.

This Court has previously recognized that, where an agency exercised its "perogative not to seek review of the invalidation of certain regulations" or where the agency admits that certain essential modifications are necessary, further review would amount to the rendering of an advisory opinion. *EPA v. Brown*, 431 U.S. 99, 103-04 (1977); *see also Center for Science in the Public Interest v. Regan*, 727 F.2d 1161 (D.C. Cir. 1984). Such would be the result here if the Court choose to review, prior to final agency action and Court of Appeals review, now void regulations which the agency is in the process of modifying.

To the extent that Petitioners seek to challenge the Order No. 500 regulations before FERC issues a final rule, their claims are not yet ripe. *See Abbott Laboratories v. Gardner*, 387 U.S. 136, 148-49 (1967). Similarly, a writ of *certiorari* is not warranted here on a theory that this is a case involving issues that are capable of repetition, yet evading review. *See, e.g., Southern Pacific Terminal Co. v. Interstate Commerce Commission*, 219 U.S. 498, 515 (1911). In response to the D.C. Circuit's opinion, FERC's interim rules have altered the agency's course, *inter alia*, by restricting the availability of "open access" transportation to deal with pipelines' take-or-pay concerns. To be sure, it is highly unlikely that the new final rule will accept the Petitioners' claim that pipelines are entitled to an unfettered right to discriminate among potential customers under a blanket transportation certificate. But the Petitioners can seek judicial review of the new final rules, with the

new access restrictions, when these rules become final.[15] There is no basis for fearing recurring mootness. More importantly, the Court's ability to resolve the issues will be better framed once FERC has promulgated those final rules.

II. NO BASIS EXISTS FOR FURTHER REVIEW OF FERC'S IMPOSITION OF AN ANTIDISCRIMINATION CONDITION UPON ITS OFFER TO PIPELINES OF BLANKET, SELF-IMPLEMENTING TRANSPORTATION AUTHORITY.

A. Adoption of the Nondiscrimination Condition Was Both Lawful and Appropriate.

Petitioners contend that, in imposing a nondiscrimination condition upon the blanket transportation authorizations of 18 C.F.R. §§ 284.8 and 284.9, FERC acted *ultra vires* of its enabling legislation.[16] This claim is patently wrong. In effect, Petitioners seek pregranted blanket, self-implementing authority to transport for whomever they choose without any restrictions designed to prevent undue discrimination, preferences or anticompetitive abuses of their monopoly power over essential transportation facilities. Their attempts to shield their anticompetitive practices behind a "common carrier" label are nothing but a ploy to avoid statutory prohibitions against undue discrimination.

To transport natural gas in interstate commerce, an interstate pipeline must first obtain from FERC a certificate of public convenience and necessity under NGA Section 7(c) authorizing the transaction, or it must obtain prior FERC approval under NGPA Section 311. The burden of proving that the public interest is served by a transaction is upon the pipeline. Traditionally,

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[15] Several parties have sought judicial review of Order No. 500. *See* n.11, *supra*.

[16] INGAA at 14; *see* TETCO at 5, AEPCO at 24; *see also* Brief in Support of ANR Pipeline Company and Colorado Interstate Gas Company ("ANR") at 7-9.

pipelines have followed the procedures outlined at 18 C.F.R. Part 157 of FERC's regulations, and have obtained specific certificate authority for each transportation in advance of performing the service. Applying for specific certificate authority under NGA Section 7(c) is a time-consuming process that entails identifying the individual customers to be served, the points of receipt and delivery of the gas, the volumes of gas, and the terms and conditions of service. Following public notice of the specific proposed transaction, FERC receives public comments. Based either on the filings or a formal hearing record, FERC will approve or disapprove the individual proposal, possibly imposing conditions deemed necessary to protect the public interest or to prevent discrimination.[17]

Order No. 436 offered pipelines an alternative to case-by-case review. As set forth at 18 C.F.R. Part 284, a pipeline may elect to obtain blanket authority under which it may transport for any shipper on a "self-implementing" basis, *i.e.*, without having obtained prior Commission authorization.[18] The blanket authorizations permit the pipeline to add new transportation customers (*i.e.*, new "shippers"); increase or decrease the volumes of gas it transports for any customer; change points of receipt and delivery; extend the term of an arrangement; and selectively discount the rates at which it offers its transportation services to particular customers in order to meet the competition.

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[17] FERC's conditioning authority is clearly established by Section 7(e) of the NGA, 15 U.S.C. § 717f(e) (1982), as well as by Section 311(c) of the NGPA, 15 U.S.C. § 3371(c) (1982). *See generally* Atlantic Ref. Co. v. Public Serv. Comm., 360 U.S. 378, 388-89 (1959).

[18] FERC granted blanket transportation authority in two forms. Under Section 7(c) of the NGA, a pipeline may obtain a blanket certificate of public convenience and necessity. Under NGPA Section 311, FERC's rules allow a pipeline to initiate transportation service merely by filing tariffs and performing the services.

Under the Order No. 436 program, interstate pipelines are offered tremendous flexibility to respond promptly to market opportunities because they need not seek FERC review of each individual proposed transaction. *Nevertheless, because FERC remains legally obligated to protect consumers from excessive rates, from exploitation at the hands of natural gas companies, and from undue discrimination and preferences,*[19] *FERC's grant of self-implementing authority is necessarily conditioned to protect the public from unjust, unreasonable and discriminatory behavior by participating pipelines.* That is, as a substitute for prior consideration of the merits of each individual transaction, FERC established certain requirements for participation in this self-implementing transportation program. One of those requirements is that participating pipelines must be willing to transport gas for all qualified customers without undue discrimination. Any pipeline which objects to Order 436's antidiscrimination condition retains the right to seek case-by-

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[19] NGA Section 4, 15 U.S.C. § 717c (1982), states in pertinent part that neither the transportation of natural gas nor its sale for resale may result in undue preference or advantage, or subject any person to undue prejudice or disadvantage. NGA Section 5, 15 U.S.C. § 717d (1982), prohibits unjust, unreasonable, unduly discriminatory or preferential rates, charges, or classifications, and it affirmatively requires FERC to remedy such conditions whenever it finds that such discriminatory practices exist. These principles are incorporated into FERC's duty under NGA Section 7(c), 15 U.S.C. § 717f(c) (1982), to impose such conditions on certificates as are necessary to serve the public convenience and necessity. *See* Atlantic Ref. Co. v. Public Serv. Comm'n, 360 U.S. 378, 388-89 (1959); FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944); *see also* Natural Gas Act Section 7(e), 15 U.S.C. § 717f(e) (1982). The courts have read Section 7 broadly to uphold certificate conditions imposed by FERC. *See* Tennessee Gas Pipeline Co. v. FERC, 689 F.2d 212, 214-15 (D.C. Cir. 1982) (broad authority to condition certificates); Transcontinental Gas Pipe Line Corp. v. FERC, 589 F.2d 186, 190 (5th Cir. 1979), *cert. denied*, 445 U.S. 915 (1980) (conditioning certificates to ensure appropriate allocation of risk); Alabama-Tennessee Nat. Gas Co. v. FPC, 203 F.2d 494, 500 (3d Cir. 1953) (imposition of rate conditions).

case approval for individual transportation transactions, just as they did for the first 40 years under the NGA.

There is no merit to Petitioners' claim that FERC did not "discover" its antidiscrimination power for nearly 50 years under the NGA and, thus, no such power exists. In reality, it was more than 40 years after the NGA was enacted before FERC first granted *blanket* transportation authority to interstate pipelines. Before such blanket authority was offered, incorporating explicit antidiscrimination rules into regulations was unnecessary because the antidiscrimination requirement is in the law and specific issues could be considered case-by-case. Since Order 436 avoids case-by-case review, the antidiscrimination condition must be established up front.[20]

Based on the record compiled in its rulemaking and two years of experience with a blanket program that lacked explicit antidiscrimination conditions, FERC concluded that, in the past, pipelines had abused a previous grant of blanket authority and performed self-implementing transportation services in an unduly discriminatory and anticompetitive manner.[21] Specifically, interstate pipelines had used their monopoly power over transmission facilities to restrain competition and to enhance their profits at the expense of consumers by maintaining noncompetitive rates for their own gas sales. Pipelines blatantly discriminated against captive LDCs and consumers: selectively transporting low-priced spot-market gas to users and LDCs that could switch to other suppliers of gas or alternative fuels, while forcing captive customers to buy the pipelines' overpriced gas. Further,

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[20] The courts have held that Congress intended to commit *to the Commission*, and not to the pipelines themselves, "the determination, by application of an informed judgment to existing facts, of the existence of forbidden preferences, advantages and discrimination." Michigan Consolidated Gas Co. v. FPC, 203 F.2d 895, 901 (3d Cir. 1953).

[21] Order No. 436, *supra* note 1, at 31,511; *AGD*, 824 F.2d at 993, 996; J.A. at 17a, 23a.

pipelines blatantly discriminated among gas producers, forcing many producers to shut in their supplies because they could not gain access to markets. Interference with natural gas price adjustments, resulting from pipelines' practices, FERC found, was causing "a very large loss to the American economy in jobs, production, and net economic efficiency."[22] From these record findings, FERC concluded that the discriminatory transportation practices of pipelines in particular, and the overall regulatory framework in general, were "allowing rates, charges, and practices which are unjust, unreasonable, and unduly discriminatory under Section 5 of the [Natural Gas Act]."[23] Under the circumstances, FERC could no longer leave to the pipelines the choice of which customers to serve under blanket authority; it was obligated under Section 5 of the NGA to remedy that discrimination in establishing the new blanket transportation program, Order No. 436.[24]

Moreover, the antidiscrimination condition in Order 436 was directly responsive to judicial guidance. The D.C. Circuit had specifically vacated the prior Order No. 234-B transportation program because the Commission had granted blanket transportation authority to pipelines but had failed to bar the undue discrimination which so predictably would result. In *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*"MPC II"*), with Justice Scalia on the panel, the court unanimously vacated that program. The court reminded FERC, *inter alia*, of its overriding duty to protect consumers from

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[22] Order No. 436, *supra* note 1, at 31,489. The *AGD* court noted that pipelines did not challenge FERC's findings as to the "extreme factual circumstances now present in the gas industry." 824 F.2d at 999-1000; J.A. at 30a.

[23] Order No. 436, *supra* note 1, at 31,490.

[24] NGA Section 5(a) is mandatory in its wording. It requires FERC to act upon finding that any natural gas company engaged in unduly discriminatory or preferential acts by ordering a just and reasonable practice to be observed thereafter.

monopolistic excesses of pipelines as well as of its duty to stand as a first line of defense against violations of the antitrust laws[25] and specifically held that FERC must condition the broad transportation program at the outset to prevent undue discrimination. *MPC II*, 761 F.2d at 787. FERC could not adequately perform its duties, the court held, by granting open-ended authority to pipelines and leaving it to consumers to try to protect themselves from discrimination through complaints.[26]

The nondiscrimination condition about which Petitioners so vociferously complain is the minimal prerequisite which must be imposed by FERC if it is going to grant pipelines *blanket* authority for self-implementing transportation. FERC is not only *empowered* to impose a nondiscrimination requirement as a condition for blanket authority to engage in a self-implementing interstate transportation—it is *compelled* to do so by Sections 4, 5 and 7 of the NGA and its own findings of fact in the Order No. 436 rulemaking. FERC is likewise empowered under Sections 311(a), 311(c) and 501(c) of the NGPA to impose a similar nondiscrimination requirement on the portion of its new program that entails transportation authorized under the NGPA.[27]

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[25] 761 F.2d at 787, *citing* Gulf States Utilities Co. v. FERC, 411 U.S. 747, 760 (1973); *see also* California v. FPC, 296 F.2d 348, 353-54 (D.C. Cir. 1961) (antitrust policies should be involved in deliberations concerning proposed certificates); City of Pittsburgh v. FPC, 237 F.2d 741, 754 (D.C. Cir. 1956) (asserting inherent power of Commission to take into account antitrust law and policy); *cf.* FPC v. Conway Corp., 426 U.S. 271, 276-79 (1976) (Commission must consider discrimination and anticompetitive consequences *before* granting approvals under the Federal Power Act).

[26] 761 F.2d at 787. Similarly, in Maryland People's Counsel v. FERC, 761 F.2d 768 (D.C. Cir. 1985) ("*MPC I*"), Justice Scalia, writing for a unanimous court, reversed a related blanket program—a so-called "special marketing program"—because of undue discrimination countenanced thereunder.

[27] FERC has broad authority to condition transportation authorized under NGPA Section 311(a), 15 U.S.C. § 3371(a) (1982),

Mindful of its regulatory responsibilities as recently articulated in *MPC I* and *MPC II*, and taking into account the record it had compiled, FERC confronted two possibilities. *First*, it could have denied pipelines any blanket transportation authority, leaving them to proceed case-by-case, with advance scrutiny of each individual transportation arrangement. Or, *second*, it could use its authority to develop an optional, blanket program with a nondiscriminatory access condition. The Commission could *not*, however,—as Petitioners would have it—grant blanket transportation authority that would allow pipelines to transport whenever and for whomever they choose.[28] Under these circumstances, FERC selected the only feasible option that would still afford pipelines the option of performing self-implementing transportation—FERC granted blanket authority subject to anti-discrimination conditions.

Lastly, if pipelines do not like the blanket transportation rules, they remain free to seek individual Section 7(c) certificates to perform transportation on a transaction-by-transaction basis. There is no merit to the complaint that pipelines lack choice or that the choice is one between the noose and a firing squad.[29] The option

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which states that FERC "may" authorize transportation by "rule or order." Section 311(c), 15 U.S.C. § 3371(c) (1982), expressly gives FERC broad power to establish the terms and conditions of transportation authorized under Section 311(a). Indeed, the statute authorizes FERC to deny Section 311 transportation altogether if it finds that such transportation would be incompatible with the public interest or with the NGPA's goal of achieving and preserving competitive wellhead pricing. Similarly, NGPA Section 501(c) provides that FERC "is authorized to perform any and all acts," and to "prescribe, issue amend, and rescind such rules and orders as it may find necessary and appropriate to carry its functions under this Act." 15 U.S.C. § 3411(a) (1982).

[28] *MPC II*, 761 F.2d 781-82; *MPC I*, 761 F.2d at 779.

[29] *AGD*, 824 F.2d at 1024. This colorful phrase appears to be one of the "stray observations" in the *AGD* opinion that inspired the concurring opinion of Judge Mikva. *See AGD*, 824 F.2d at 1044

of case-by-case approval is all that pipelines had for the first 40 years of regulation and it is all that the law requires. Many pipelines—including Petitioner Texas Eastern—have, in fact, refused or are currently refusing to implement blanket transportation services.[30]

In sum, in light of the specific record evidence, the nondiscrimination condition adopted by FERC as part of its optional blanket grant of authority simply enforces the statutory ban on undue discrimination, preferences and unjust and unreasonable rates and services. Moreover, this condition appears to be the only *effective* mechanism to prevent unduly discriminatory practices under self-implementing blanket certificates.[31]

B. FERC's Nondiscriminatory Access Condition Is Neither Compulsory Nor Does It Require Gas Pipelines to Transport Gas As Common Carriers.

AEPCO argues that Order No. 436 and the nondiscriminatory access rules therein will "radically transform" gas pipelines into common carriers. (AEPCO at 9.) Both FERC and the *AGD* court correctly rejected the argument that FERC's "open access" condition is

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(Mikva, J., concurring). The expert agency found that the program is voluntary and structured its rules to assure the availability of the traditional Section 7(c) option. Experience has borne this out. *See* n.30, *infra*.

[30] Many pipelines have "opened" and then "closed" their systems, taking full advantage of the voluntary aspect of the program. As of the date of printing hereof, only 10 of the 24 major interstate pipeline companies have accepted a blanket certificate under Order No. 436/500. They are: ANR Pipeline Co., Columbia Gas Transmission Corp., Columbia Gulf Transmission Co., Consolidated Gas Transmission Corp., Natural Gas Pipeline Co. of America, Northern Border Pipeline Co., Northern Natural Gas Co., Tennessee Gas Pipeline Co., Trunkline Gas Co., and United Gas Pipe Line Co.

[31] *Cf.* Permian Basin Area Rate Cases, 390 U.S. 747, 780 (1968) (absent compelling evidence of a contrary congressional intent, courts may not prohibit administrative action that is imperative to the achievement of an agency's ultimate purposes).

equivalent to a "common carriage" requirement. (824 F.2d at 997; J.A. at 24a.) *Certiorari* should not be granted to reward Petitioners for their war of labels.

First, Order No. 436 does not mandate common carrier status. It does not *require* pipelines to transport for anyone.[32] Order No. 436 merely states that if pipelines elect to transport on a self-implementing basis, without prior Commission review and approval, they must agree to do so in an open and nondiscriminatory manner. Second, the concept of "common carriage" is legally distinct from that of nondiscrimination.[33] The NGA has long prohibited "undue discrimination" or "preferences" and required FERC to remedy discrimination; yet the NGA is not viewed as "common carrier" law.[34]

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[32] FERC asserted that a primary distinction between its actions in Order No. 436 and common carriage is that "a principal attribute of common carrier status [is] its *mandatory* nature." Order No. 436, *supra* note 1, at 31,500. The *AGD* court saw the competitive and economic forces surrounding the decision by a pipeline whether or not to transport in accordance with Order No. 436 as nullifying the "voluntariness" rationale. 824 F.2d at 1014; J.A. at 62(a).

[33] In *Pennsylvania Railroad v. Sonman Shaft Coal Co.*, 242 U.S. 120, 123-26 (1916), for example, the Court allowed a coal company which had received from a railroad fewer cars than it had requested for transportation of its coal, to maintain an action against this unfair and discriminatory treatment independent of its claims arising under the Interstate Commerce Act. The Court recognized a duty to avoid discriminatory treatment as distinct from the duty to abide by common carrier regulation. *Id.*

[34] The distinction between common carriage and nondiscriminatory access is also recognized in several federal statutes regulating gas pipelines. In the Mineral Leasing Act, 30 U.S.C. § 185(r)(2)(A), for example, gas pipelines are made subject to a nondiscriminatory access condition, but are exempted from common carrier provisions applicable to oil pipelines under Section 185 (r)(3)(A). *See also* S. REP. No. 207, 93d Cong., 1st Sess., *reprinted in* [1973] U.S. CODE CONG. & AD. NEWS 2417, 2440 (nondiscrimination requirement is not limited by qualified exemption of gas pipelines from common carrier requirements). The Outer

If gas pipelines operating under Order No. 436 must be labelled, it is evident that they are acting not as "common carriers" but as "contract carriers," under the traditional meaning of that term. The legal distinction between "contract" (or private) and "common" carriers has been described as "difficult to establish" in practice and attended by "confusion" and "turmoil." [35] The at-

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Continental Shelf Lands Act Amendments of 1978 require oil and gas pipelines operating in the Outer Continental Shelf ("OCS") to "provide open and nondiscriminatory access to both owner and non-owner shippers." 30 U.S.C. § 1334(f)(1)(A). Again, however, this language was deemed not to be the equivalent of imposing common carrier status on such pipelines. *See* H. REP. No. 1474, 95th Cong., 2d Sess. 87 (1978); H. REP. No. 590, 95th Cong., 1st Sess. (1977) (bills requiring OCS pipelines to be operated as common carriers rejected). Section 13(a) of the Alaska Natural Gas Transportation Act, 15 U.S.C. § 719k ("ANGTA"), requires that certificates be conditioned to provide that no person seeking to transport gas on the system may be discriminated against based on the degree of ownership. FERC's Office of the General Counsel analyzed the legislative history of ANGTA and concluded that Congress did not intend the Alaskan gas pipeline to be a common carrier. *See* Northwest Alaskan Pipeline Co., 3 FERC (CCH) ¶ 61,226 at 61,604-07 (1978).

[35] *See* Campbell, *The Contract Carrier: A History of the Concept*, 29 I.C.C. PRAC. J. 952, 958 (May 1962); Hirschbach, *The Contract Motor Carrier—A Substitute for Private Carriage or a Common Carrier in Disguise?*, 18 S.D.L. REV. 10, 12 (Winter 1973); *see generally* L. Gorton, THE CONCEPT OF THE COMMON CARRIER IN ANGLO-AMERICAN LAW 183-86 (1971); *see also* Note, *Carriers: Common Carriage Distinguished from Contract Carriage: United States v. Contract Steel Carriers*, 350 U.S. 409 (1956), 43 CORNELL L. Q. 96, 99 (1957) [hereinafter "Cornell Note"] (Although some decisions have suggested that one distinction between common and contract carriage involves the ability of a contract carrier to select and reject shippers for whom it will haul, "this test seems questionable.") The distinction is further blurred because some entities that are treated as common carriers for their firm transportation services are regulated as contract carriers for their interuptible services. Hirschbach, *supra*, at 15-16 (return trip shipments, or those to fill the excess capacity of transporters, were traditionally treated as contract carriage).

tributes of Order No. 436 transportation, however, differ significantly from common law concepts of common carriage and are more akin to contract carriage than to common carriage.

First, as noted, the nondiscrimination condition is optional because the entire program is optional. Common carrier status under common law is mandatory for anyone engaged in the relevant business.

Second, common carriers generally are not allowed to offer discounts or rebates from their published rates. *See United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 345 (1946). In contrast, although a gas pipeline operating under Order No. 436 must file tariffs at FERC publishing its maximum and minimum transportation rates, it is free to practice "selective discounting" within that range without such discounting being deemed unduly discriminatory. *See* 18 C.F.R. § 284.7(d)(5) (1987); App. A at 1a-2a.

Third, in cases of insufficient pipeline capacity, FERC has interpreted Order No. 436 to permit a pipeline to curtail service to the party with the last-executed contract(s) before curtailing transportation to others.[36] In contrast, common law common carriage dictates that, in cases of limited pipeline capacity, all shippers must be afforded some capacity on a *pro rata* basis.[37]

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[36] *See, e.g.*, El Paso Natural Gas Co., 35 FERC (CCH) ¶ 61,440 at 62,061 (1986), *reh. denied*, 38 FERC (CCH) ¶ 61,008 (1987), *appeal docketed sub nom.* Mobil Oil Expl. & Prod., Southeast, Inc. v. FERC, No. 87-4016 (5th Cir., filed Jan. 13, 1987), *motion for remand granted* (Sept. 10, 1987).

[37] *See, e.g.*, Belle Fourche Pipeline Co., 28 FERC (CCH) ¶ 61,150 at 61,281-82 (1984); Powder River Pipeline Corp. v. Amoco Pipeline Co., 10 FERC (CCH) ¶ 61,044 at 61,108 (1980); *id.*, 4 FERC (CCH) ¶ 61,338 at 61,811 (1978); J. Hansen, UNITED STATES OIL PIPELINE MARKETS 73 (MIT Press 1983) (oil pipelines, which are common carriers under the Interstate Commerce Act, must afford proportionate service during times of insufficient capacity).

Fourth, Order No. 436 transportation requires the parties to enter into a formal contractual relationship with at least some major terms and conditions left to specific negotiation between the parties (*e.g.*, term of service, responsibility for construction costs, ownership of taps and other hook-ups, responsibility for installation and maintenance of metering devices). In contrast, "[c]ommon carriers, as a general rule, do not require the signing of a specific contract, or, at least, the shipper is not usually aware of signing such a contract." [38]

In addition, Order No. 436 transportation deviates from the traditional definition of common carriage in other ways as well. For example, FERC tolerates a priority for sales and transportation customers which had contracts with the pipeline prior to the date FERC acted on its blanket certificate application.[39] FERC also allows existing firm sales customers of the pipeline that are converting to transportation to receive a priority in the allocation of transportation capacity. 18 C.F.R. § 284.10 (c) (1987); App. A at 18a-20a. Such priorities are inconsistent with common law common carriage.

C. NGPA Section 602(b)(2) Was Not Designed to Restrain FERC from Imposing Nondiscriminatory Access Conditions on Blanket Transportation Authorizations.

Petitioners view NGPA Section 602(b)(2)[40] as a Congressional prohibition on the Commission's use of its broad authority under NGPA Sections 311(c) and 501(a) to condition transportation authorized under NGPA Sec-

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[38] Campbell, *supra* note 35, at 963; *see also* Hirschbach, *supra* note 35, at 15-16 (dedication of equipment [*e.g.*, lines, taps, meters] to the exclusive use of a shipper is a hallmark of contract carriage).

[39] *See, e.g.*, Texas Eastern Transmission Corp., 41 FERC (CCH) ¶ 61,015 at 61,027 (1987), *appeal docketed*, Texaco, Inc. v. FERC, No. 87-4735 (5th Cir., filed Oct. 15, 1987); Texas Eastern Transmission Corp. v. FERC, No. 87-1774 (D.C. Cir., filed Dec. 15, 1987).

[40] App. A at 1a.

tion 311(a). (INGAA at 14-17; AEPCO at 10-17, TETCO at 9-14; *see also* ANR at 8.) FERC and the *AGD* court soundly rejected that interpretation. 824 F.2d at 1002-03; J.A. at 35a. Moreover, nothing in the legislative history of those sections supports that interpretation. Instead, it appears that Section 602(b) was merely intended to allay the concerns of interstate and intrastate pipelines that they would inadvertently become subject to *other* state or federal common carrier statutes[41] solely "by reason of" either volunteering to perform transportation authorized by FERC under Section 311(a) or by responding to a presidential order requiring transportation in an emergency.[42] As the *AGD*

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[41] The *AGD* court identified Texas case law, opinions of the attorney general, and statutes that could have been triggered by a pipeline engaging in Section 311(a) transportation. 824 F.2d at 1002. *See also* MICH. COMP. LAWS ANN. § 483.110 (West 1979). The *AGD* court did not find comparable federal statutes; however, several such miscellaneous statutes exist that impose duties on or create an exposure for common carriers that is not applicable to non-common carriers. *See, e.g.*, Clayton Act, § 10, 15 U.S.C. § 20 (1982) (prohibiting common carriers from certain dealings in securities, supplies, or contracts with companies with whom they have interlocking directorates); Tariff Act of 1930, § 551, 19 U.S.C. § 1551 (1982) (authorizing Secretary of Treasury to impose bonding requirements on common carriers); Act of March 19, 1918, § 1, 15 U.S.C. § 261 (1982) (requiring common carriers to observe standard time zones); Employers' Liability Act, § 10, 45 U.S.C. § 60 (1982) (imposing penalties on common carriers for preventing employees from furnishing information concerning deaths or injuries); Foreign Intelligence Surveillance Act of 1978, § 105, 50 U.S.C. § 1805 (b)(2)(B) (1982) (automatically obligating common carriers to furnish information, facilities and technical assistance to aid in accomplishing secret surveillance); Postal Reorganization Act, § 603, 39 U.S.C. § 603 (1982) (allowing Postal Service searches of common carrier offices). The quoted language could also have been intended to protect pipelines transporting under NGPA Section 311 from both "overlooked" federal provisions and/or future federal provisions yet to be enacted.

[42] *See* National Energy Act, Report of the Ad Hoc Committee on Energy, U.S. House of Representatives, on H.R. 8444, Rep. No.

court noted, if pipelines refused to transport under Section 311(a) because of the risk of additional federal or state obligations, that refusal would impede the statutory purpose of removing a major barrier between interstate and intrastate movement of gas. 824 F.2d at 1002; J.A. at 35a-36a.

Petitioners dispute the interpretation of NGPA Section 602(b)(2) adopted by the court below. They claim that Congress intended this section to be read as a specific limitation on FERC authority to regulate gas pipelines. (AEPCO at 10-12; INGAA at 14-15; TETCO at 9-10.) This claim ignores the fact that Congress used nearly identical language in two other gas regulatory acts passed the same day as the NGPA to protect *end users* from being subject to regulation as common carriers under Federal or State law solely by virtue of their voluntary actions to comply with those acts.[43] The appearance of comparable provisions in other contemporaneous acts confirms that Section 602(b)(2) was *not* enacted to protect pipelines from FERC efforts to remedy their unduly discriminatory practices.

The *AGD* court's interpretation of the scope of NGPA Section 602(b) is further supported by the title of Sec-

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95-543, 95th Cong., 1st Sess. 45 (1977); 123 CONG. REC. H.R. 8382 (Aug. 3, 1977). Pipelines previously had been insulated from common carrier statutes due to the bifurcation of interstate and intrastate markets maintained by the Natural Gas Act.

[43] *See* Public Utility Regulatory Policies Act of 1978, § 606(f)(2), 15 U.S.C. § 717(f)(2) (1982) (gas users would not become common carriers if they voluntarily converted to heavy fuel oil and sold, transported or assigned their contracts for gas supplies to pipelines, distributors or high priority users); Powerplant and Industrial Fuel Use Act of 1978, § 731(f)(2), 15 U.S.C. § 8441(f)(2) (1982) (any person receiving gas for a use outlawed by the act may transfer its interest in such gas without becoming subject to regulation as a common carrier under any provision of Federal or State law solely by virtue of its sale, transportation or assignment of such gas rights).

tion 602—"Effect on State Laws."[44] This title clearly signals that the primary purpose of Section 602(b) was to insulate pipelines engaged in Section 311(a) transportation from being treated as common carriers under state laws, not to force FERC to condone undue discrimination and anticompetitive practices by pipelines.[45]

The *AGD* court further buttressed its interpretation of NGPA Section 602 by noting, correctly, that Congress hardly could have intended a limitation on the President's powers to order gas transportation in an emergency, if the President were to order transportation akin to that of common carriage. 824 F.2d at 1003; J.A. at 37a. In addition, even though the *AGD* court reached an independent conclusion that NGPA Section 602(b)(2) does not bar FERC from conditioning transportation pursuant to Section 311(a) on a commitment to provide nondiscriminatory access, it also upheld FERC's own interpretation of Section 602 as reasonable.[46]

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[44] When section titles are enacted as part of a statute, as they were in the NGPA, they may be used in the process of statutory construction. *See* 2A SUTHERLAND STATUTORY CONSTR. § 47.14, at 151 (4th ed. 1984); Office of Consumers' Counsel v. FERC, 783 F.2d 206, 219 (D.C. Cir. 1986) (beginning interpretation of NGPA § 601(c)(2) by reviewing its title).

[45] If Congress had intended Section 602(b)(2) to operate as a limitation on FERC's power under the NGPA to authorize transportation subject to conditions needed to protect the public interest, as Petitioners allege, this limitation would have been included in Section 311 itself, and not in a separate title for "miscellaneous" provisions in a section entitled "Effect on State Laws."

[46] 824 F.2d at 1003; J.A. at 37a, *citing* Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984). This Court's teachings in *Chevron* dictate that, when there are two or more equally plausible readings of a statute, the question for a reviewing court is whether the agency's construction is a permissible one. 467 U.S. at 843 & n.11.

D. Midwest Video is Neither Relevant Nor Controlling.

Petitioners rely heavily on this Court's decision in *FCC v. Midwest Video Corp.*, 440 U.S. 689 (1979) (*"Midwest Video II"*), to contend that Order No. 436 improperly forces pipelines to become common carriers because, they allege, the nondiscriminatory access condition set forth at Sections 284.8(b) and 284.9(b) of FERC's regulations is the "essence of common carriage." (AEPCO at 9-12; INGAA at 7-9; TETCO at 5-6.) However, *Midwest Video II* interpreted and applied the concept of "common carriage" in the highly particularized context of the Communications Act of 1934 ("Communications Act" or "Act"),[47] and not in the context of the gas acts. Based on the significant dissimilarities between the legislative purposes and statutory structure of the Communications Act, on the one hand, and the NGA and the NGPA on the other, the Court of Appeals found, correctly, that *Midwest Video II* is of marginal relevance in the context of gas pipeline regulation. 824 F.2d at 998; J.A. at 27a.

First, the structure of the NGA and the NGPA is plainly different from that of the Communications Act. Specifically, the two natural gas statutes do not share the Communications Act's bifurcated structure[48] in which two mutually exclusive congressional objectives are expressed. Significantly, Title III of the Communications Act (regulating broadcasters) contains no antidiscrimination provision and gives the FCC no authority to impose a nondiscrimination requirement. Accordingly, this Court held in *Midwest Video II* the FCC had no authority under Title III to promulgate the cable television access rules at issue there.

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[47] 47 U.S.C. §§ 151, *et seq.* (1982).

[48] Title II of that Act regulates radio common carriers and requires open access to all would-be users of common carrier service. Title III, discussed in the text, is fundamentally different.

By contrast, the Natural Gas Act does *explicitly* require FERC to *assure* that natural gas companies do not grant undue preferences or advantages or otherwise engage in unduly discriminatory behavior. Natural Gas Act §§ 4(b), 5(a), 15 U.S.C. §§ 717c(b), 717d(a) (1982). Further, FERC has broad authority to prohibit discrimination and unreasonable transportation practices under the NGPA. *See* NGPA §§ 311(c), 501(a), 15 U.S.C. §§ 3371(c), 3411(a) (1982). Thus, there is a clear and logical nexus between FERC's jurisdiction to regulate gas transportation services and its power to order nondiscriminatory access as a condition to an optional blanket transportation program. It was the presence of just such a nexus that caused this Court to uphold the FCC's cable television program origination rules in *Midwest Video I*,[49] while rejecting its access rules in *Midwest Video II*, when no statutory nexus was shown. *See* 440 U.S. at 700.

Second, the Congressional purpose of journalistic independence, which justified overturning the FCC's access rules, finds no parallel in the gas statutes. The "unusual order of First Amendment values" [50] implicated in regulating the broadcast media is simply inapplicable to the regulation of natural gas companies.

Third, in *Midwest Video II*, the FCC's rules required open access behavior by *all* cable operators. In contrast, FERC has merely offered an optional alternative to the traditional method of obtaining authority to transport gas in interstate commerce. As noted, Order 436 permits, but does not require, self-implementing transportation services subject to a nondiscrimination condition which substitutes for prior FERC review of each transaction.

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[49] United States v. Midwest Video Corp., 406 U.S. 649 (1972).

[50] *See* Columbia Broadcasting System, Inc. v. Democratic National Committee, 412 U.S. 94, 101 (1973); *see also* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 389 (1969).

III. SoCAL'S CHALLENGES TO THE OPTIONAL EXPEDITED CERTIFICATE REGULATIONS DO NOT WARRANT A WRIT OF CERTIORARI.

A. SoCal's Challenges are Premature.

At the outset, it bears emphasis that Petitioner Southern California Gas Company ("SoCal") challenges the Optional Expedited Certificate ("OEC") regulations only with respect to a single potential application of the OEC rules, *i.e.*, insofar as they potentially permit an interstate pipeline to "bypass" an LDC. By "bypass" SoCal has in mind the fear that its monopoly may not be absolute because an interstate pipeline might in the future be allowed to serve directly a customer which was traditionally a customer of SoCal.

Although the OEC regulations might, in the future, be invoked by an interstate pipeline that directly seeks to serve an existing customer of an LDC, it remains speculative whether the OEC rules will ever produce the results feared by SoCal. The OEC regulations apply broadly to a variety of potential transactions for which a certificate of public convenience and necessity is required under the NGA. For example, the OEC procedures may be invoked for expedited approval of a pipeline's construction of new facilities and/or rendition of new services for the direct benefit of LDCs [51] or fellow pipelines or end users who are not currently buying gas from anyone.[52] To date, the Commission has issued but one

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[51] For example, several LDC affiliates are partners in an OEC proposal for a project that would import natural gas from Canada largely for LDC system supply. *See* Iroquois Gas Transmission Co., FERC Docket No. CP86-523. Curiously, SoCal appears mistakenly to suggest that this proposed OEC project, which would benefit its fellow LDCs and Northeast U.S. consumers generally, is a proposed bypass of an LDC.

[52] For example, one OEC application proposes to serve the California enhanced oil recovery ("EOR") market. Wyoming-California Pipeline Company, 52 Fed. Reg. 23266 (June 26, 1986) (hereinafter

OEC certificate, and it is intended to benefit an LDC.[53]

Further, as the court below correctly determined,[54] the OEC procedures are not yet ripe for review because it remains to be seen whether FERC will deny a request for hearing with respect to an OEC application.[55] Even if FERC does deny a live hearing in a particular case, the circumstances may warrant denial of the hearing in that case.[56] In any event, whether the application of the OEC procedures would deprive a protestant of its rights cannot be determined in the abstract in this proceeding but must be resolved based on the factual record of an individual proceeding.[57]

B. The OEC Regulations Are Within FERC's Statutory Authority.

Fundamentally, SoCal bases its argument on the erroneous premise that the OEC regulations create an irrebuttable presumption in favor of LDC bypass. The regulations do not address bypass *per se*. Based on sub-

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"Wy-Cal"). Although SoCal contends that the proposed service would result in bypass, in fact much of the EOR market is not currently burning natural gas, and thus this is largely a case of SoCal competing with a pipeline for a new market.

[53] Moraine Pipeline Company, 42 FERC (CCH) ¶ 61,144 (February 2, 1988).

[54] *AGD*, 824 F.2d at 1031-33.

[55] Indeed, FERC may well modify the OEC procedures as part of its final self-implementing transportation rule.

[56] Formal hearings, for example, are not required under the NGA when there are no material issues of fact in dispute. *See* Cerro Wire & Cable Co. v. FERC, 677 F.2d 124, 128-29 (D.C. Cir. 1982).

[57] SoCal has intervened in the Wy-Cal proceeding and will have the opportunity there to seek review of the OEC procedures in a concrete factual setting if (1) its rights are denied and (2) FERC grants that application. SoCal's attack on the OEC regulations appears to be motivated by its desire to protect its regulatory monopoly against competition for new markets from Wy-Cal's proposal to build a new interstate pipeline. Consequently, its challenge properly lies there.

stantial record evidence, however, the OEC regulations do include a rebuttable presumption in favor of applicants that satisfy criteria designed by the FERC to assure that they assume the full economic risk of the venture. Both the FERC and the court below considered and properly rejected arguments by SoCal Gas and others that bypass would shift costs to residential customers. Such claims are at best speculative and, moreover, are contradicted by record evidence.

SoCal's argument that FERC abruptly changed a long-standing policy favoring service by LDCs over direct pipeline service to end users is incorrect. While some decisions have provided for service by an LDC rather than directly by a pipeline, this has by no means been a consistent rule.[58] Furthermore, FERC may change any alleged policy in favor of service by LDCs where, as here, circumstances warrant a new policy.

Contrary to SoCal's assertion, the OEC's rebuttable presumption does not improperly shift the burden of proof.[59] Under traditional NGA Section 7(c) procedures, the applicant has the burden of establishing a *prima facie* case that the certificate is required by the public convenience and necessity and, thereafter, the burden of going forward with evidence shifts to the protestant.[60] The OEC procedures simply expedite the initial burden of going forward through the use of a presumption which may be rebutted by appropriate evidence. In any

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[58] *See, e.g.*, Opinion 275-A, Panhandle Eastern Pipe Line Company, 40 FERC (CCH) ¶ 61,220 (1987); American Distribution Company (Alabama Division), 37 FERC (CCH) ¶ 61,282 (Dec. 23, 1986).

[59] In Order Nos. 436 and 436-A FERC made clear that "[b]urden of proof issues, to the extent that they arise in individual cases, will be resolved in accordance with the Administrative Procedure Act ["APA"]." Order No. 436, *supra*, note 1, at 31,584-85; J.A. at C-121 through 122.

[60] *See* Transcontinental Gas Pipeline Corporation, 33 F.P.C. 237, 265 (1965).

event, the Commission will make a specific finding as to whether the public convenience and necessity are served in each case,[61] and any aggrieved party may seek judicial review.

SoCal's reliance upon *American Distribution Company (Alabama Division)*,[62] is misplaced. That case did *not* involve an OEC proceeding, but rather was a traditional NGA Section 7 certificate application seeking authority to serve a municipal distribution system for ultimate redelivery to an industrial customer.

Finally, SoCal's assertion that it merely seeks the "opportunity for specific review of bypass applications which consider all relevant factors" is misleading. *First*, the OEC regulations provide it with such an opportunity. The regulations require that, in the case of a proposed bypass, an affected LDC and state commission must be given direct notice. Those parties will be provided an opportunity to rebut the presumption in favor of an OEC application. *Second*, SoCal is really seeking a procedural vehicle designed to defeat competition by interjecting needless delay through protracted formal proceedings. Use of such delay to block competition is contrary to the public interest and wholly inconsistent with the aims of the NGPA and the broad competitive goals supported by the FERC's rulemaking.

C. There Is No Jurisdictional Conflict.

SoCal presents no jurisdictional issues that would warrant issuance of a writ of *certiorari*. SoCal's argument concerning an alleged need to clarify the scope of state jurisdiction over transportation within its boundaries is based on the incorrect premise that, through its OEC

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[61] To illustrate, in approving the only OEC certificate granted to date, the FERC held that "based on the evidence in the record before us, *and without relying on any presumption*, we find that Moraine's proposal as modified, is required by the public convenience and necessity" (emphasis added). Moraine Pipeline Co., *supra* note 53, mimeo at 18.

[62] 37 FERC (CCH) ¶ 61,282 (1986).

regulations, FERC has abandoned regulation of an aspect of interstate transportation. Contrary to SoCal, FERC will continue to exercise its jurisdiction to regulate the interstate transportation of gas to end users just as it has in the past. FERC has simply reduced the danger of pointless litigation delay in cases in which the parties to a transaction assume the full economic risks of their transaction. FERC's OEC rules have not created a regulatory gap, nor has SoCal set forth any basis for interfering with FERC's exercise in this instance of its exclusive jurisdiction over interstate transportation of natural gas.

CONCLUSION

For the foregoing reasons, the Petitioners for Writ of Certiorari addressed herein should be denied.

Respectfully submitted,

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March 16, 1988

APPENDIX A

APPENDIX A

NGPA Section 602(b), 15 U.S.C. § 3432(b) (1982):

EFFECT ON STATE LAWS.

. . .

(b) Common Carriers.—No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—

(1) [pursuant to presidential order requiring transportation in an emergency; or]

(2) authorized by the Commission under section 311(a) of this Act.

18 C.F.R. Part 284:

§ 284.7 **Rates.**

* * * *

(d) Rate design.

* * * *

(5) Rate flexibility.

(i) Any rate schedule filed under this section must state a maximum rate and a minimum rate.

(ii) The pipeline may charge an individual customer any rate that is neither greater than the maximum rate nor less than the minimum rate on file for that service.

(iii) The pipeline may not file a revised or new rate designed to recover costs not recovered under rates previously in effect.

(iv) If, during any billing period, a pipeline charges a rate or collects a reservation fee that is less than the maximum rate or fee, the pipeline must, within 15 days of the close of the billing period, file a report with the Commission identifying:

(A) The maximum rate or fee and the rate or fee actually charged during the billing period;

(B) The shipper; and

(C) Any corporate affiliation between the shipper and the transporting pipeline.

§ 284.8 Firm transportation service.

(a) *Firm transportation availability.* (1) An interstate pipeline that provides transportation service under Subpart B, G or H must offer such transportation service on a firm basis.

(2) An intrastate pipeline that provides transportation service under Subpart C may offer such transportation service on a firm basis.

(3) "Service on a firm basis" means that the service is not subject to a prior claim by another customer or another class of service and receives the same priority as any other class of firm service.

(b) *Non-discriminatory access.* An interstate pipeline or intrastate pipeline that offers transportation service on a firm basis under Subpart B, C, G or H must provide such service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind.

(c) *Reasonable operational conditions.* Consistent with paragraph (b) of this section, a pipeline may impose reasonable operational conditions on any service provided under this part. Such conditions must be filed by the pipeline as part of its transportation tariff.

(d) *Reservation fee.* Where a customer purchases firm service, a pipeline may impose a reservation fee or charge on a shipper as a condition for providing such service. The reservation fee may not recover any variable costs or any fixed costs in excess of those costs that would be recovered by using the same ratemaking meth-

odology used for determining the demand charge in the pipeline's sales rates. Except as provided in this paragraph, the pipeline may not include in a rate for any transportation service provided under Subpart B, C, G or H any minimum bill or minimum take provision, or any other provision that has the effect of guaranteeing revenue.

(e) *Limitation.* A person providing service under Subpart B, C, G or H of this part is not required to provide any requested transportation service for which capacity is not available or that would require the construction or acquisition of any new facilities.

(f) (1) *Transportation credits.* Natural gas is eligible for transportation by interstate pipelines under this part only if:

(i) The pipeline and the shipper or producer agree, or

(ii) An offer has been submitted to the pipeline satisfying the requirements of paragraph (f)(2) of this section.

(2) An offer to satisfy this section need not be notarized but must:

(i) Identify the gas made eligible for transportation through the filing of the offer,

(ii) Be signed by the producer and all other persons who own at least 85 percent of the volumes of gas for which take-or-pay or take-and-pay credits are required to be offered under this section in connection with the transportation of the subject gas, and

(iii) Constitute an offer, which upon acceptance by the pipeline will result in a contract binding on the producers and their assignees, to grant the pipeline any credits under this section in connection with the transportation of the subject gas. The requirements of this section may be satisfied by a general offer applicable to all transportation transactions involving the subject gas.

(iv) Where a pipeline receives offer(s) of credits covering at least 85 percent of the volumes to be transported and signed by the producers and all other persons required to offer take-or-pay or take-and-pay credits under this section in connection with the transportation of the subject gas, the pipeline must be provided with the names of the persons or entities that have not signed and comprise the 15 percent (or lower) volumetric minority.

(v) If, at any time after the commencement of a transaction under section 284.8(f)(2)(iv) above, any one of those producers or other persons that did not submit an offer of credits should subsequently sign and tender a document offering take-or-pay and take-and-pay credits pursuant to this part, then that producer or other person must also provide credits for any of its volumes transported in the transaction where it was in the 15 percent (or lower) volumetric minority not signing an offer of credits.

(3) Once the offer and names required by this section are submitted to the pipeline, the pipeline must transport the gas, subject to the conditions of this part, notwithstanding any dispute concerning either the adequacy of the offer made under § 284.8(f)(1)(ii) or how the crediting is to be performed.

(4) If a pipeline is requested to transport gas which on June 23, 1987, was owned by a producer who on that date owned gas sold to the pipeline under a contract or contracts executed before June 23, 1987, which contain take-or-pay or take-and-pay provisions, and receives the offer required by paragraph (f)(2) of this section, the pipeline may receive credits as follows:

(i) For each unit of gas transported that is owned by that producer on June 23, 1987, the pipeline will receive credit for the volumes transported as though they were volumes of that producer's gas purchased by the pipeline under any contract existing on or before June 23, 1987, which contains a take-or-pay or take-and-pay provision.

(ii) The selection of the contracts against which the credits will apply will be at the discretion of the pipeline. However, the pipeline may not apply credits against its obligation, under a take-and-pay contract, to take gas which under state law in effect on June 23, 1987, was defined as casinghead gas.

(iii) The pipeline may, at its discretion, apply the credit as though the volumes were purchased in the contract year in which the gas was transported or in any previous calendar year, commencing on or after January 1, 1986, in which the pipeline transported natural gas pursuant to the nondiscriminatory access provisions of §§ 284.8(b) and 284.9(b) of this part.

(iv) When a pipeline has released gas from a gas purchase contract and, as part of the release agreement, the parties have agreed to a crediting of the released gas against the pipeline's take-or-pay or take-and-pay liability under that contract, the releasing pipeline nonetheless may, at its discretion, receive credits pursuant to this section for transporting the released gas. However, the pipeline may not receive more than a volume for volume credit. Therefore, if a pipeline chooses to receive credits under this section, it must discharge the producer from all other crediting arrangements agreed to in the release agreement or otherwise provided in the gas purchase contract. In addition, for purposes of determining the pipeline's take-or-pay liability under the released contract, the pipeline may not claim that the annual deliverability of gas under the released contract is reduced by the volumes credited against another contract.

(v) If, as a result of the release, there are insufficient gas reserves subject to the release contract to allow the pipeline to receive delivery of gas for which it has made prepayments pursuant to the released contract, the producer must, at its option, either repay the prepayments to the extent of any insufficiency caused by the release or satisfy any make up rights of the pipeline under the contract through delivery of a like quantity of

gas from either gas committed to the contract which was credited or some other source.

(vi) If the transported gas was not owned by any producer on June 23, 1987, the pipeline may receive credits, as provided in this section.

(5) When the gas is transported by more than one pipeline and the gas was released from a contract between the producer and one of the transporting pipelines, only the pipeline which is a party to the contract from which the gas is released may receive credit under this section. No other pipeline providing transportation may receive a credit. In all other cases, when more than one pipeline is requested to transport the same gas, the credit is to be applied to the take-or-pay or take-and-pay obligations of all the pipelines engaged in the transaction but is not required to exceed the amount of the gas transported. The pipelines may agree among themselves how the credits should be allocated among their prepayment obligations. Failure by the pipelines to agree as to such an allocation of the credits will not render the gas ineligible for transportation. If transportation begins before the pipelines agree on an allocation formula, the allocation formula subsequently agreed upon will apply from the date transportation commenced.

(6) If on September 15, 1987, a pipeline is transporing gas owned by a producer on June 23, 1987, that gas will cease to be eligible for transportation under this part on January 1, 1988, unless the pipeline and the shipper or producer agree, or an offer of take-or-pay or take-and-pay credits has been submitted to the pipeline, as provided under paragraph (f)(2), offering the pipeline credits. Such credits shall commence from the date the offer of credits is submitted.

(7) Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in order to obtain transportation of:

(i) Gas which:

(A) The producer formerly sold to the transporting pipeline under a contract which contained a take-or-pay or take-and-pay provision and which has been terminated, and

(B) Is not currently subject to a gas purchase contract between the pipeline and the producer, or

(ii) Gas which has been released from a gas purchase contract which contains or is subject to a market-out clause giving the purchaser the right to terminate the contract at the purchaser's discretion.

(8) *New natural gas.* Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in order to obtain transportation of Order No. 500 new natural gas, as defined in paragraph (i). Also, a pipeline may not apply credits arising from the transportation of other gas against take-or-pay or take-and-pay obligations for Order No. 500 new natural gas.

(i) Order No. 500 new natural gas is:

(A) Natural gas produced from an Order No. 500 new well (as defined in paragraph ii) which is 2.5 miles or more from the nearest Order No. 500 marker well (as defined in paragraph iii) or from any completion location of any Order No. 500 new well which is located at a depth of least 1,000 feet below the deepest completion location of each Order No. 500 marker well within 2.5 miles of such new well, or

(B) Natural gas produced from an Order No. 500 new well and from a reservoir from which natural gas was not produced in commercial quantities before June 23, 1987.

(ii) An Order No. 500 new well is any well the surface drilling of which began on or after June 23, 1987 or the depth of which was increased, by means of drilling

on or after June 23, 1987, to a completion location which is located at least 1,000 feet below the depth of the deepest completion location of such well attained before June 23, 1987.

(iii) An Order No. 500 marker well is any well from which natural gas was produced in commercial quantities at any time after January 1, 1970 and before June 23, 1987.

(iv) For purposes of determining the distance from any Order No. 500 new well to any Order No. 500 marker well, the measurement shall be the horizontal distance from the surface location of the Order No. 500 new well to the surface location of the Order No. 500 marker well.

(9) *Intrastate system supply.* Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in connection with an interstate pipeline's transportation after January 1, 1988 of gas released from an intrastate pipeline's system supply gas, for average daily quantities transported by the interstate pipeline which do not exceed the average daily quantities transported in November 1987 under its reported transaction, if:

(i) The intrastate pipeline has released that gas under a release agreement providing the intrastate pipeline take-or-pay credits for transporting that gas against the pipeline's take-or-pay or take-and-pay liability under the contract from which the gas has been released,

(ii) The intrastate pipeline and interstate pipeline transport the gas in transactions commenced on or before November 15, 1987,

(iii) The intrastate pipeline reported its transportation transaction to the Commission pursuant to § 284.126 (a), and

(iv) The interstate pipeline reported its transportation transaction to the Commission pursuant to § 284.106.

(10) *Special rule for certain processing plant resales.*

(i) Natural gas which a processing plant operator purchased under percentage-of-proceeds contracts, entered into on or before June 23, 1987, with behind-the-plant producers and which the processing plant operator resells at the plant's tailgate is eligible for transportation by interstate pipelines when:

(A) The pipeline and the shipper or processing plant operator agree, or

(B) An offer has been submitted to the pipeline (*1*) signed by the processing plant operator and (*2*) identifying the gas made eligible for transportation through the filing of the offer, (*3*) which, upon acceptance of the pipeline, will result in a contract binding on the processing plant operator to grant the pipeline credits, as provided in this section subject to the limitation in paragraph (f)(10)(ii), in connection with the transportation of the subject gas.

(ii) Credits arising from the transportation after January 1, 1988 of the gas described in paragraph (f)(10)(i) may be applied only against the transporting pipeline's take-or-pay or take-and-pay obligation under a pre-June 23, 1987 contract with the processing plant operator from which that pipeline has released the transported gas.

(11) *Offers to act as a guarantor.* (i) Where the working interest owners of 85 percent of the gas tendered for transportation do not sign offers of credits, that gas nevertheless shall be eligible for transportation if some other person offers to act as guarantor for nonsigning producers such that 85 percent of the gas is covered either by offers or credits or offers to act as guarantor.

(ii) An offer to act as guarantor must:

(A) Identify the gas which will be transported pursuant to the offer and the producer of that gas,

(B) Be signed by the guarantor, and

(C) Constitute an offer, which upon acceptance by the pipeline, will result in a contract binding on the guarantor to pay the pipeline the amount by which the pipeline's take-or-pay or take-and-pay payments to the producer would have been reduced had the producer offered the pipeline credits under Order No. 500.

§ 284.9 Interruptible transportation service.

(a) Interruptible transportation availability. (1) An interstate pipeline that provides firm transportation under Subpart B, G or H must also offer transportation service on an interruptible basis under that subpart or subparts.

(2) An intrastate pipeline that provides transportation service under Subpart C may offer such transportation service on an interruptible basis.

(3) "Service on an interruptible basis" means that the capacity used to provide the service is subject to a prior claim by another customer or another class of service and receives a lower priority than such other classes of service.

(b) *Non-discriminatory access.* An interstate or intrastate pipeline that offers interruptible service under Subpart B, C, G or H must provide such service without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind.

(c) *Reasonable operational conditions.* Consistent with paragraph (b) of this section, a pipeline may impose

reasonable operational conditions on any service provided under this part. Such conditions must be filed by the pipeline as part of its transportation tariff.

(d) *Reservation fee.* No reservation fee may be imposed for interruptible service. A pipeline's rate for any transportation service provided under this section may not include any minimum bill provision, minimum take provision, or any other provision that has the effect of guaranteeing revenue.

(e) *Limitation.* A person providing service under Subparts B, C, G or H of this part is not required to provide any requested transportation service for which capacity is not available or that would require the construction or acquisition of any new facilities.

(f)(1) *Transportation credits.* Natural gas is eligible for transportation by interstate pipelines under this part only if:

(i) The pipeline and the shipper or producer agree, or

(ii) An offer has been submitted to the pipeline satisfying the requirements of paragraph (f)(2) of this section.

(2) An offer to satisfy this section need not be notarized but must:

(i) Identify the gas made eligible for transportation through the filing of the offer,

(ii) Be signed by the producer and all other persons who own at least 85 percent of the volumes of gas for which take-or-pay or take-and-pay credits are required to be offered under this section in connection with the transportation of the subject gas, and

(iii) Constitute an offer, which upon acceptance by the pipeline will result in a contract binding on the producers and their assignees, to grant the pipeline any credits under this section in connection with the transportation of the subject gas. The requirements of this section may

be satisfied by a general offer applicable to all transportation transactions involving the subject gas.

(iv) Where a pipeline receives offer(s) of credits covering at least 85 percent of the volumes to be transported and signed by the producers and all other persons required to offer take-or-pay or take-and-pay credits under this section in connection with the transportation of the subject gas, the pipeline must be provided with the names of the persons or entities that have not signed and comprise the 15 percent (or lower) volumetric minority.

(v) If, at any time after the commencement of a transaction under section 284.9(f)(2)(iv) above, any one of those producers or other persons that did not submit an offer of credits should subsequently sign and tender a document offering take-or-pay and take-and-pay credits pursuant to this part, then that producer or other person must also provide credits for any of its volumes transported in the transaction where it was in the 15 percent (or lower) volumetric minority not signing an offer of credits.

(3) Once the offer and names required by this section are submitted to the pipeline, the pipeline must transport the gas, subject to the conditions of this part, notwithstanding any dispute concerning either the adequacy of the offer made under § 284.9(f)(1)(ii) or how the crediting is to be performed.

(4) If a pipeline is requested to transport gas which on June 23, 1987, was owned by a producer who on that date owned gas sold to the pipeline under a contract or contracts executed before June 23, 1987, which contains take-or-pay or take-and-pay provisions, and receives the offer required by paragraph (f)(2) of this section, the pipeline may receive credits as follows:

(i) For each unit of gas transported that is owned by that producer on June 23, 1987, the pipeline will receive credit for the volumes transported as though they were

volumes of that producer's gas purchased by the pipeline under any contract existing on or before June 23, 1987, which contains a take-or-pay or take-and-pay provision.

(ii) The selection of the contracts against which the credits will apply will be at the discretion of the pipeline. However, the pipeline may not apply credits against its obligation, under a take-and-pay contract, to take gas which under state law in effect on June 23, 1987, was defined as casinghead gas.

(iii) The pipeline may, at its discretion, apply the credit as though the volumes were purchased in the contract year in which the gas was transported or in any previous calendar year, commencing on or after January 1, 1986, in which the pipeline transported natural gas pursuant to the nondiscriminatory access provisions of §§ 284.8(b) and 284.9(b) of this part.

(iv) When a pipeline has released gas from a gas purchase contract and, as part of the release agreement, the parties have agreed to a crediting of the released gas against the pipeline's take-or-pay or take-and-pay liability under that contract, the releasing pipeline nonetheless may, at its discretion, receive credits pursuant to this section for transporting the released gas. However, the pipeline may not receive more than a volume for volume credit. Therefore, if a pipeline chooses to receive credits under this section, it must discharge the producer from all other crediting arrangements agreed to in the release agreement or otherwise provided in the gas purchase contract. In addition, for purposes of determining the pipeline's take-or-pay liability under the released contract, the pipeline may not claim that the annual deliverability of gas under the released contract is reduced by the volumes credited against another contract.

(v) If, as a result of the release, there are insufficient gas reserves subject to the release contract to allow the pipeline to receive delivery of gas for which it has made prepayments pursuant to the released contract, the pro-

ducer must, at its option, either repay the prepayments to the extent of any insufficiency caused by the release or satisfy any make up rights of the pipeline under the contract through delivery of a like quantity of gas from either gas committed to the contract which was credited or some other source.

(vi) If the transported gas was not owned by any producer on June 23, 1987, the pipeline may receive credits as provided in this section.

(5) When the gas is transported by more than one pipeline and the gas was released from a contract between the producer and one of the transporting pipelines, only the pipeline which is a party to the contract from which the gas is released may receive credit under this section. No other pipeline providing transportation may receive a credit. In all other cases, when more than one pipeline is requested to transport the same gas, the credit is to be applied to the take-or-pay or take-and-pay obligations of all the pipelines engaged in the transaction but is not required to exceed the amount of the gas transported. The pipelines may agree among themselves how the credits should be allocated among their prepayment obligations. Failure by the pipelines to agree as to such an allocation of the credits will not render the gas ineligible for transportation. If transportation begins before the pipelines agree on an allocation formula, the allocation formula subsequently agreed upon will apply from the date transportation commenced.

(6) If on September 15, 1987, a pipeline is transporting gas owned by a producer on June 23, 1987, that gas will cease to be eligible for transportation under this part on January 1, 1988, unless the pipeline and the shipper or producer agree, or an offer of take-or-pay or take-and-pay credits has been submitted to the pipeline, as provided under paragraph (f)(2), offering the pipeline credits. Such credits shall commence from the date the offer of credits is submitted.

(7) Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in order to obtain transportation of:

(i) Gas which:

(A) The producer formerly sold to the transporting pipeline under a contract which contained a take-or-pay or take-and-pay provision and which has been terminated and

(B) Is not currently subject to a gas purchase contract between the pipeline and the producer, or

(ii) Gas which has been released from a gas purchase contract which contains or is subject to a market-out clause giving the purchaser the right to terminate the contract at the purchaser's discretion.

(8) *New natural gas.* Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in order to obtain transportation of Order No. 500 new natural gas, as defined in paragraph (i). Also, a pipeline may not apply credits arising from the transportation of other gas against take-or-pay or take-and-pay obligations for Order No. 500 new natural gas.

(i) Order No. 500 new natural gas is: (A) Natural gas produced from an Order No. 500 new well (as defined in paragraph ii) which is 2.5 miles or more from the nearest Order No. 500 marker well (as defined in paragraph iii) or from any completion location of any Order No. 500 new well which is located at a depth at least 1,000 feet below the deepest completion location of each Order No. 500 marker well within 2.5 miles of such new well, or

(B) Natural gas produced from an Order No. 500 new well and from a reservoir from which natural gas

was not produced in commercial quantities before June 23, 1987.

(ii) An Order No. 500 new well is any well the surface drilling of which began on or after June 23, 1987 or the depth of which was increased, by means of drilling on or after June 23, 1987, to a completion location which is located at least 1,000 feet below the depth of the deepest completion location of such well attained before June 23, 1987.

(iii) An Order No. 500 marker well is any well from which natural gas was produced in commercial quantities at any time after January 1, 1970 and before June 23, 1987.

(iv) For purposes of determining the distance from any Order No. 500 new well to any Order No. 500 marker well, the measurement shall be the horizontal distance from the surface location of the Order No. 500 new well to the surface location of the Order No. 500 marker well.

(9) *Intrastate system supply.* Notwithstanding the above provisions, a producer is not required under this section to provide credits with respect to take-or-pay or take-and-pay obligations in connection with an interstate pipeline's transportation after January 1, 1988 of gas released from an intrastate pipeline's system supply gas, for average daily quantities transported by the interstate pipeline which do not exceed the average daily quantities transported in November 1987 under its reported transaction, if:

(i) The intrastate pipeline has released that gas under a release agreement providing the intrastate pipeline take-or-pay credits for transporting that gas against the pipeline's take-or-pay or take-and-pay liability under the contract from which the gas has been released,

(ii) The intrastate pipeline and interstate pipeline transport the gas in transactions commenced on or before November 15, 1987,

(iii) The intrastate pipeline reported its transportation transaction to the Commission pursuant to §284.126(a), and

(iv) The interstate pipeline reported its transportation transaction to the Commission pursuant to § 284.106.

(10) *Special rule for certain processing plant resales.*

(i) Natural gas which a processing plant operator purchased under percentage-of-proceeds contracts, entered into on or before June 23, 1987, with behind-the-plant producers and which the processing plant operator resells at the plant's tailgate is eligible for transportation by interstate pipelines when:

(A) The pipeline and the shipper or processing plant operator agree, or

(B) An offer has been submitted to the pipeline (1) signed by the processing plant operator and (2) identifying the gas made eligible for transportation through the filing of the offer, (3) which, upon acceptance of the pipeline, will result in a contract binding on the processing plant operator to grant the pipeline credits, as provided in this section subject to the limitation in paragraph (f)(10)(ii), in connection with the transportation of the subject gas.

(ii) Credits arising from the transportation from after January 1, 1988 of the gas described in paragraph (f)(10)(i) may be applied only against the transporting pipeline's take-or-pay or take-and-pay obligation under a pre-June 23, 1987 contract with the processing plant operator from which that pipeline has released the transported gas.

(11) Offers to act as guarantor. (i) Where the working interest owners of 85 percent of the gas tendered for transportation do not sign offers of credits, that gas nevertheless shall be eligible for transportation if some other person offers to act as guarantor for nonsigning producers such that 85 percent of the gas is covered either by offers of credits or offers to act as guarantor.

(ii) An offer to act as guarantor must: (A) Identify the gas which will be transported pursuant to the offer and the producer of that gas,

(B) Be signed by the guarantor, and

(C) Constitute an offer, which upon acceptance by the pipeline, will result in a contract binding on the guarantor to pay the pipeline the amount by which the pipeline's take-or-pay or take-and-pay payments to the producer would have been reduced had the producer offered the pipeline credits under Order No. 500.

§ 284.10 Conversion to firm transportation.

* * * *

(c) *Procedures.*

(1) *Customer option.* An interstate pipeline subject to this section agrees to offer, and is deemed to offer, each firm sales customer the option, under this paragraph, to convert a portion of its firm sales entitlements under any eligible firm sales service agreement to a volumetrically equal amount of firm transportation service.

(2) *Notice.* Unless the pipeline agrees otherwise, a customer that wishes to exercise its option under this paragraph must provide the pipeline written notice not later than 60 days before the proposed conversion.

(3) *Level of conversion.* (i) A customer of a pipeline subject to this section may convert to firm transportation its existing firm sales entitlements under any eligible firm sales service agreement with that pipeline, in accordance with the following schedule:

(A) During the first twelve-month period after the pipeline first becomes subject to this section, up to 15 percent of the level of its firm sales entitlements in existence on the date the pipeline first becomes subject to

this section, under any eligible firm sales service agreement with that pipeline;

(B) During the second twelve-month period after the pipeline first becomes subject to this section, up to 30 percent of the level of its firm sales entitlements in existence on the date the pipeline first becomes subject to this section, under any eligible firm sales service agreement with that pipeline;

(C) During the third twelve-month period after the pipeline first becomes subject to this section, up to 50 percent of the level of its firm sales entitlements in existence on the date the pipeline first becomes subject to this section, under any eligible firm sales service agreement with that pipeline;

(D) During the fourth twelve-month period after the pipeline first becomes subject to this section, up to 75 percent of the level of its firm sales entitlements in existence on the date the pipeline first becomes subject to this section, under any eligible firm sales service agreement with that pipeline; and

(E) Beginning the fifth twelve-month period after the pipeline first becomes subject to this section, up to 100 percent of the level of its firm sales entitlements in existence on the date the pipeline first becomes subject to this section, under any eligible firm sales service agreement with that pipeline;

(ii) A pipeline subject to this section may, at any time, permit a firm sales customer to convert to firm transportation by more than the amount provided in the schedule in paragraph (c)(3)(i) of this section.

(4) *Reservation fee.* Where a customer exercises its option under this paragraph to convert to firm transportation service, the pipeline may impose a reservation fee as provided in § 284.8(d) of this subpart.

(5) *Effect of conversion on minimum bills.* If a customer converts under this paragraph any portion of its firm sales entitlements from a pipeline, each unit of firm transportation service purchased must be credited to any minimum commodity bill obligation that the customer may have under its firm sales service agreements with that pipeline.

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